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IN THE

Supreme Court of the United States.

OCTOBER TERM, 1952.

No. 133 .

JAMES F. MASTERSON, MICHAEL STELLA, EVA LEFKER and OTIS & COMPANY,

Petitioners,

v.

JEROME R. PERGAMENT and GEORGE J. LONDON, *et al.*, JOSEPH W. FRAZER and HENRY J. KAISER, *et al.*,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT.

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Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT.

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

James F. Masterson, Michael Stella, Eva Lefker and Otis & Company, stockholders of Kaiser-Frazer Corporation, objecting to the approval of a settlement of certain stockholders' derivative actions in a proceeding under Rule 23(c) of the Federal Rules of Civil Procedure, respectfully pray for the issuance of a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit entered herein March 23, 1953, approving such settlement.

Basis of Jurisdiction.

The jurisdiction of this Court is invoked under 28 U. S. C. § 1254. The judgment of the Court of Appeals was entered March 23, 1953 (R. 9-4731).[1]

Opinions Below.

The opinion of the District Court approving the settlement is reported in 93 F. Supp. 13. The opinions of the Court of Appeals affirming the order of the District Court, Judge Allen dissenting, are reported in 203 F. (2d) 315. They are printed in Volume 9 of the Record.

Court Rule Involved.

Rule 23(c) F. R. C. P. provides in its pertinent portion:

> "(c) Dismissal or Compromise. A class action shall not be dismissed or compromised without the approval of the court. If the right sought to be enforced is one defined in paragraph (1) of subdivision (a) of this rule notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs. * * *"

Summary Statement.

The issue presented by this petition is whether this Court will review the holding of a majority of the

[1] Record references will be made by volume and page. References to exhibits will be made similarly, the exhibit volumes being independently numbered 1 etc., followed by the page reference and the letters "ex."

Court below that a District Judge may, under Rule 23(c) of the Federal Rules of Civil Procedure, approve the settlement of a stockholders' derivative action regardless of the fact that its negotiation constituted a constructive fraud upon the stockholders of the corporation. The majority below expressly declined to consider the points that "the negotiators of the settlement on behalf of the corporation (*i. e.*, counsel for plaintiffs in the stockholders' action used by defendants as a vehicle for the settlement) were not fully informed; that material information was concealed from them; that the lawyers participating occupied a dual role; or that there was no arm's length bargaining" (R. 9-4758). In the majority's view these facts were immaterial, since under Rule 23(c) the settlement agreement could not become effective without approval of the District Judge; the latter "was therefore a third party to the compromise,"; and, there being no contention that "important information was concealed from him or that his participation in the settlement was subject to any infirmity," antecedent fraud among the other parties to the settlement was of no moment (*ibid.*).

The issue arises on substantially undisputed facts, which are set out in considerable detail in Judge Allen's opinion, "originally prepared by her for the Court, which must now be classified as a dissent" (R. 9-4756).[2] In her opinion, "the settlement should be set aside because of unfairness in the negotiations" (R. 9-4745)—the majority not disputing the unfairness, but dismissing it as irrelevant. She concluded that the majority holding subverts the purpose of Rule 23(c) (R. 9-4745). Under such a holding, the Rule,

[2] The case was *sub judice* in the Court of Appeals for over a year.

instead of being a protection to stockholders against fraudulent and collusive settlements, becomes an instrument for effecting them with judicial approval.

The issue presented, involving the construction of Rule 23(c), has never been decided by this Court. The decision of the majority below nullifies existing law that settlements of stockholders' derivative actions will be set aside if there is unfairness or fraud in either the bargaining or the result. It assigns new and non-judicial functions to the District Judges, in authorizing them to act upon business judgment as to the merits of the settlement despite the fact that it was not honestly arrived at.

In the settlement at bar, the unfairness in the negotiations was not incidental but of the essence. Large claims, held below to have substantial merit, were advanced on behalf of Kaiser-Frazer Corporation in six stockholders' suits pending in various jurisdictions against the Kaisers and Frazer, who were controlling officers and directors, against affiliated corporations controlled by them, and against other officers and directors of Kaiser-Frazer. The lawyers for the defendant officers and directors were also counsel for Kaiser-Frazer. They selected one of the actions, in which the plaintiffs' attorneys were considered "friendly lawyers" (R. 9-4743), as the vehicle of settlement. Without disclosure to plaintiffs in the other actions or their lawyers, a settlement was reached. Lawyers for the plaintiffs in the selected action were largely uninformed as to the facts. As a condition for the settlement, counsel for the defendants required counsel for the settling plaintiffs to amend their complaint so as to include all the sub-

stantial causes of action in the other five suits. The admitted purpose was to foreclose the prosecution of any of these actions.

The actions sought to be foreclosed by the settlement thus arrived at involved claims that were extremely valuable to Kaiser-Frazer. All the judges in the district and appellate courts so found, the amounts recognized by the different judges ranging from $2,300,000 to $10,700,000 or more. All the claims were for violation of fiduciary responsibility by controlling insiders of Kaiser-Frazer. The record here shows a series of contracts and deals between Kaiser-Frazer and personally owned Kaiser and Frazer companies, from which the latter derived great profits without corresponding consideration to the corporation, and a course of self-dealing by which assets and opportunities of Kaiser-Frazer were diverted to the personal benefit of the companies owned and/or controlled by Kaiser and Frazer themselves.

Contrasting with the huge profits received by the insiders in breach of fiduciary duty, is the record of losses sustained by the public stockholders. Kaiser-Frazer was organized in 1945. In that year and in 1946 it sold to the public approximately $57,000,000 of common stock at $10 and $20.25 per share, respectively. No dividends have been paid on the stock. The Corporation has lost more than $54,000,000 to March 31, 1953. The market value of its stock has ranged from 23½ to 2⅞ and is, at the writing of this brief, less than $4 per share.

Statement.

In the following discussion we refer to Judge Allen's opinion for the facts found below, particularizing them somewhat more fully in the Appendix following the petition. The majority opinion did not take issue as to these facts, but, assuming them to be true, held that they were immaterial for the reasons above stated.

In October 1949 there were pending in state and federal courts in Michigan, New York, Delaware and California six stockholders' suits on behalf of Kaiser-Fraser. These suits were against Henry J. Kaiser and Joseph Frazer, Chairman of the Board and President, respectively, of Kaiser-Frazer, their fellow officers and directors, certain corporations owned and controlled by the Kaiser family, and Graham-Paige Corporation, an affiliated company of which Frazer was President. These suits collectively presented nine causes of action arising out of transactions between Kaiser-Frazer, the Kaisers, Frazer, and the companies referred to above, which involved self-dealing and large-scale profit taking by the defendants.[3]

On October 25, 1949 Kaiser-Frazer and the principal defendants entered into an agreement with "friendly lawyers" (R. 9-4743) who represented Pergament and London, the plaintiffs in one of these suits, whereby Kaiser-Frazer released these nine

[3] The various interlocking relationships are set forth at R. 9-4739, footnote 1. The California suit was inactive and will not be hereafter considered.

claims for considerations hereinafter explained, which were largely intangible. The suit selected by the defendants as the venicle of settlement was then pending in the District Court below; accordingly, plaintiffs and Kaiser-Frazer, controlled by the Kaiser interests and Frazer, brought on the agreement of settlement for approval under Rule 23(c) in that Court. After hearing, the District Court approved the settlement; and, on appeal, such approval was affirmed by the majority below on the grounds heretofore stated.

The District Judge found merit in three of the nine claims settled, upon evidence which indicated their value at $2,300,000 to $4,100,000 in round figures, exclusive of interest. The Court of Appeals found merit in another cause of action which fairly added a further principal liability of $1,700,000, bringing the total to $4,000,000 to $5,800,000. Judge Allen valued these claims up to a total of $10,500,000. In addition, Judge Allen was of the opinion that another action, relating to the so-called "Permanente" claim, had merit; and all the judges agreed that if this Permanente claim was meritorious it was of sufficient magnitude, standing alone, to invalidate the settlement for inadequacy.[4]

The settlement agreement provided that for these claims, Kaiser-Frazer would get tangible considerations worth at most $820,000, plus the partial guaranty by the Kaiser interests of a loan to Kaiser-Frazer from Reconstruction Finance Corporation (RFC). The $820,000, standing alone, was admittedly

[4] The above is a condensation of undisputed facts which are set forth in greater detail at pp. vi-xii of the Appendix attached hereto. The Permanente claim is discussed at Appendix pp. ix-xii.

inadequate to support the settlement, and principal reliance was placed by the District Judge and the majority of the Court of Appeals on the guaranty. They were unable to put a dollar value upon it, but held it was sufficient, combined with the tangible considerations, to justify the settlement, because it enabled Kaiser-Frazer to continue in business.[5] It is a sharply disputed question, whether the guaranty really constituted any consideration at all (Appendix, pp. xii-xv). However, the central issue herein and the questions presented would not be affected, even if it were assumed that the guaranty was *bona fide* consideration.

Toward the end of September, 1949, matters were in this position: Kaiser-Frazer had to have the RFC loan in order to continue; but the RFC would not extend the loan without the Kaisers' guaranty to the extent of $15,000,000 thereof; and "Kaiser-Frazer was in default upon bank loans of $16,000,000 guaranteed by the Kaiser interests, and faced the threat of liquidation" (R. 9-4736), so that the Kaisers, in guaranteeing the RFC loan to the extent of $15,000,000, would be bailing themselves out of liability to the extent of $16,000,000 under their guaranty of the defaulted bank loans.

Thereupon Henry Kaiser and his attorneys, the latter acting nominally for Kaiser-Frazer but actually for the settling defendants, conceived the plan of getting rid of the stockholders' suits by a settlement in

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[5] This thought the District Judge expressed in the phrase that "Kaiser-Frazer breathes again" and has a "fighting chance to exist" (R. 1-251, 257). The majority of the Court of Appeals said that the guaranty gave Kaiser-Frazer a "chance to live" which "may not fail" (R. 9-4770).

which the giving of the $15,000,000 guaranty for the RFC loan would be the principal consideration. Kaiser's attorneys, Judge Allen wrote, "picked the suit that they would settle, with its friendly lawyers" (R. 9-4743), and entered with them into a settlement agreement that was so negotiated as to "constitute constructive fraud upon the stockholders of Kaiser-Frazer" (R. 9-4745).

In summary, Judge Allen found (R. 9-4737 to 4745) that the settlement negotiations were characterized by the following: absence of arms-length negotiations; lack of true adversary relationship between the negotiators; inadequate representation of the Kaiser-Frazer stockholders by the settling stockholders; concealment and suppression of material facts by the attorneys for Kaiser-Frazer, who were paid by the company and acting nominally for it, but were really representing the settling defendants and conceded, in a "striking admission" commented on by Judge Allen at R. 9-4737-8, that they were trying to get the best possible bargain for such defendants and the least possible recovery for the company; uninformed action by the attorneys for the settling stockholders; exclusion from the negotiations of representatives of all other suing stockholders; last-minute amendments of the complaint in the suit being settled, so as to bring in claims never considered or evaluated by the settling stockholders or pleaded in their complaint, (but pleaded in other actions), not for the purpose of litigating such claims but for the purpose of getting rid of them; and lack of effective representation of stockholders in general in the settlement negotiations. This was capped by "approval" of the settlement by the Kaiser-Frazer Board, all but one of whom were defendants, and all of

whom were interested adversely to the company. The settlement gave sweeping releases of causes of action, known and unknown, not only to contributing defendants but also to financially responsible defendants who were paying nothing.[6]

The construction of Rule 23(c) by the majority below, under which they held these undisputed facts to be immaterial, raises the following questions:

Questions Presented.

(1) Does Rule 23(c) F. R. C. P. permit a federal District Court judicially to approve a settlement of meritorious corporate claims which has been fraudulently negotiated?

(2) Assuming that Rule 23(c) confers no such *judicial* power, does it confer upon the District Judge a business or administrative discretion, sitting as a "third party to the compromise", to approve for business reasons, as "for the best interests" of the company, a settlement which sitting as a judge he would have had to disapprove for fraud in the *factum*?

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[6] Judge Allen said on this point (R. 9-4742-3): "The releases included in the proposed settlement emphasize the lack of effective representation by Chess and Perlman [attorneys for the settling stockholders]. The general releases covered three non-contributing defendants, * * * primarily liable if the District Court's conclusion that the Fleetwings door transaction, the Graham-Paige receipt of undervalued stock from Kaiser-Frazer, and the Muntz Car Company distributorship matter presented cases of merit. * * * These releases were of course desirable for the defendants but hardly beneficial to Kaiser-Frazer and other stockholders. Brown, [an attorney acting nominally for Kaiser-Frazer who made the striking admission referred to above], a chief negotiator for the settlement on behalf of the defendants, director and secretary of Kaiser-Frazer, and admittedly acting in dual capacities, was released on motion of the plaintiffs prior to the hearing."

(3) Could this Court in the exercise of its rule-making power constitutionally have vested such non-judicial power in a federal constitutional court?

(4) Is the holding that a federal court has power to approve a settlement which under applicable state law is invalid for fraud in the *factum*, consistent with the doctrine of *Erie Railroad* v. *Tompkins*, 304 U. S. 64?

(5) However the alleged power to approve a settlement for business reasons as in the interest of a corporation be described, and whatever be the source of such power, is it not an abuse of discretion to approve a settlement of meritorious claims which is vitiated by fraud in the *factum*?

Reasons for Granting the Writ.

(1) *The Court below has decided an important question of federal law which has not been, but should be, settled by this Court.*

No one disputes that, Rule 23(c) aside, the settlement of a corporate claim against corporate fiduciaries must be fairly negotiated, otherwise the court will set it aside if executed or refuse to approve it if executory. This is but a corollary to the general rule that all contracts between fiduciary and *cestui*, where permissible at all, must be fairly negotiated as well as fair in result. Restatement of Restitution, § 191. This rule applies with full force to dealings between corporations and their officers and directors. *Pepper* v. *Litton*, 308 U. S. 295, 306; *Geddes* v. *Anaconda Copper Mining Co.*, 254 U. S. 590, 599.[7] Accordingly, in

[7] *Cf. American United Mutual Life Ins. Co.* v. *City of Avon Park*, 311 U. S. 138, 145, 146, where this Court insisted upon full

approving settlement of a litigation between a corporation and its directors courts have heretofore insisted upon a showing of good faith in negotiating the settlement before considering its merits. *Goodwin* v. *Castleton,* 19 Wash. 2d 748, 144 Pac. 2d 725; *Karasik* v. *Pacific Eastern Corporation,* 21 Del. Chan. 81, 180 Atl. 604; *Perrine* v. *Pennroad Corporation,* 47 Atl. 2d 479 (Del.), cert. den. 329 U. S. 808; *Feldman* v. *Pennroad Corp.,* 155 F. 2d 773 (C. A. 3), cert. den. 329 U. S. 808.

The above principles have not been questioned by the respondents herein or the courts below. What has been held is, that under Rule 23(c) they no longer apply. This is a novel and unfortunate doctrine in a field of great importance.[8]

Prior to the decision below, it was not thought that the rule was any different in settlements consummated without court approval, and those which must be approved under Rule 23(c). On the contrary, the common assumption was that Rule 23(c) was intended to provide an *additional* safeguard against secret, fraudulent, or collusive settlements in derivative suits, by subjecting the honesty of the bargaining in those cases to the scrutiny of a court at the threshold. Hence courts acting heretofore under Rule 23 have

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disclosure as the "very minimum requirement for fair dealing," and noted the lower court's responsibility to be satisfied that the transaction (in that case a plan for reorganization) "embodies a fair and equitable bargain openly arrived at and devoid of overreaching, however subtle".

[8] This Court has recognized in *Cohen* v. *Beneficial Industrial Loan Corp.,* 337 U. S. 541, 547-9, the importance of the stockholders' derivative suit in protecting stockholders against unscrupulous management.

held that they would proceed to a consideration of the merits of the settlement only after finding that the settlement was fairly bargained. *Denicke* v. *Anglo-California National Bank,* 45 F. Supp. 524, affd. 141 F. 2d 285 (C. A. 9), cert. den. 323 U. S. 739; *Winkelman* v. *General Motors Corporation,* 48 F. Supp. 490 (D. C. N. Y.); *Fielding* v. *Allen,* 99 F. Supp. 137 (D. C. N. Y.).

The case at bar holds otherwise. The majority below find in Rule 23(c) a grant of power to the District Court to dispense with accepted judicial standards, which require fair bargaining as the *sine qua non* for valid settlement, and to approve the bargain as "a third party to the compromise" notwithstanding fraud in the *factum.* The phrase "third party" is, of course, a misnomer. Under the doctrine approved by the majority below, the District Judge becomes not the "third party" to the compromise, but the *sole* representative of the corporate *cestui,* and his decision is final. This was exactly what the settling stockholders argued in the Court of Appeals;[9] and the majority so held. Acting on the assumption that under Rule 23(c) *"'ratification' is by the court,"* the District Judge in the instant case has imposed on Kaiser-Frazer an undeniably fraudulent settlement, approved by a wholly disqualified Board,

[9] In their brief below the settling stockholders argued (p. 52): "* * * All of the cases relied upon by appellants in this connection, including the much cited *Irving Trust Co.* v. *Deutsch,* 73 F. 2d 121, involve completed releases. In none of them was application *first* made to the court, as in the case at bar, before the release became effective. In the ordinary trustee-*cestui* relationship, the ratification is by the *cestui.* In representative actions, including stockholder derivative suits, such 'ratification' is by the court. * * *" (Emphasis in original.)

contrary to the wishes of four-fifths of the stockholders represented in court, holding or controlling more than 11,000 shares as against 8 shares eligible to sue under Rule 23(b), held by the settling stockholders (see Appendix, pp. i-ii). Obviously the District Judge was not exercising judicial power but was acting as business arbiter with power of final decision.

In construing the provision of Rule 23(c) that "A class action shall not be * * * compromised without the approval of the court" as if it read "The court may approve a compromise irrespective of fraud in the *factum* if he finds that the settlement is nevertheless in the interest of the company," the majority below, we think, surpasses fair interpretation. We further question the apparent assumptions which led the majority to adopt such an interpretation. It is, we believe, pertinent to inquire:

1. Even assuming that the corporation has come out of the fraudulent negotiation with a settlement that in the judge's opinion is permissible, is it not entitled to the chance in fair arms-length negotiation to procure a better settlement?

2. Is it reasonable to assume that a fraudulently negotiated compromise will ever be as favorable to the corporation as one honestly negotiated? If so, why the fraud?

3. Is a judicial surmise that, the fraud notwithstanding, the corporation did as well as could be expected, an acceptable substitute for honest bargaining in the corporation's behalf? What is there in the bare words of 23(c), "approval of the court," to suggest

that it was intended to substitute the judicial surmise for the tested workings of honest, informed, effective bargaining? What is there in the special training and experience of the judiciary to support the notion that this Court intended to vest them with this extraordinary, non-judicial power in corporate affairs?

4. Exactly what duties have the majority imposed upon the District Judge in setting him up as a "third party to the compromise"? The only thing plain is, that acting as a party he does not sit as a judge; was that the intent of 23(c)? In the capacity of "third party", is he to be neutral or to represent the stockholders or the management; surely not the latter, since Rule 23(c) was not intended to protect management against stockholders. Even if he is a neutral, should he not recognize, in accordance with all human experience, that fraud in the negotiations must have affected the result and attempt to redress the balance by bargaining up the amount received in settlement? If he is not to do that—and concededly the District Judge did *not* do it in the case at bar—then how does the scheme of Rule 23(c), as envisioned by the majority, replace the function of honest initial negotiation?

The heretofore settled practice under Rule 23(c), which required a showing of fair negotiation before passing to the merits of the settlement, militates heavily against the construction given that Rule by the majority below. The confusions and problems that follow upon departure from the settled practice emphasize both the unwisdom of such departure, and the unlikelihood that it expresses this Court's intent in promulgating Rule 23.

The available judicial guidance is also against the construction put upon Rule 23 by the majority below. In *Cohen* v. *Beneficial Industrial Loan Corporation, supra,* 337 U. S. 541, a state statute required the posting of a bond as a condition of prosecuting a stockholders' derivative action. It was argued that this statute did not apply to actions in the federal court; and it was urged, among other things, that Rule 23 had preempted the field of derivative litigation in federal courts. This Court, however, having held that the state requirement for a bond was substantive rather than procedural within the meaning of *Erie,* said, at page 556, that "These provisions neither create nor exempt from liabilities" [imposed by state law]; and that they do not "conflict with the statute in question" but require in addition notice to the parties and disclosure to the court. If "these provisions" do not "exempt from liabilities" such as posting a bond, the well established prerequisite of honest bargaining before settlement would appear equally unaffected by the Rule.

Although in construing Rule 23 none of the Courts of Appeal has had before it the precise point here presented, every Court which has spoken on the subject has clearly manifested its understanding that the discretion of the District Court under Rule 23(c) is confined to a sound judicial discretion exercised in accordance with the usual judicial canons. Thus, *Upson* v. *Otis,* 155 F. 2d 606, 614 (C. A. 2), reversing the lower Court for acting non-judicially, admonished it that upon retrial it should decide the matter "on the correct legal rules applicable to the facts thus established" and further reminded the District Court (p. 614, footnotes 8 and 9) that such correct legal rules invalidate settlements

between fiduciaries and their *cestuis* which are either unfair in the negotiation or unfair in the result. In *Cohen* v. *Young,* 127 F. 2d 721, 726, the Sixth Circuit, speaking through a different bench than the one that decided the case at bar, reminded the District Court that discretion in a Rule 23(c) case "does not permit the court to disregard the substantive principles of law established for the protection of litigants."

(2) *The Court below, in holding that Rule 23(c) vests the District Court with non-judicial duties and powers, has decided an important question of federal law in a way in conflict with applicable decisions of this Court.*

Whether the District Judge is a "third party" to the settlement or the sole representative of the corporate *cestui* with final power, it is clear that the status, function, and power conferred upon him by the majority below are non-judicial. They are non-judicial in what they compel him to ignore, viz., the usual judicial canons. They are non-judicial in what they require him to do, viz., sitting as party and not as court, to trade out and accept or reject compromises of litigation. They are non-judicial in what they empower him to make the basis of decision, viz., his view of the business merits of the settlement, irrespective of facts such as actually occurred in the case at bar: fraud in its making, the disqualification of the company's Board, and the failure of the settling stockholders to give adequate representation to the company and its stockholders. They are non-judicial, finally, in that the discretion said to

be vested in the judge is in the nature of things an unreviewable discretion; for when the standards fixed by applicable law are abandoned, and there is substituted a business man's estimate as to the merits of the settlement, no canons exist by which judicial review may be intelligently exercised. All that is presented is the possibility that the appellate judges, sitting as a board of business review, may so far differ with the District Court as to conclude that he could not reasonably have made the estimate of business probabilities that he did make.

The difference between business judgment and judicial discretion, in the precise context of the case at bar, finds succinct expression in *Karasik* v. *Pacific Eastern Corporation, supra,* 21 Del. Chan. 81, 180 A. 604. There the Court in the following language contrasted its judicial power in approving the settlement of a stockholders' action with its administrative power in directing its receiver to approve or disapprove the settlement of similar claims by the corporation in receivership (180 Atl. at p. 612):

> "In that case [directing the receiver] the Chancellor was acting as a substitute for directors and was exercising his business judgment. In this case [approving a settlement in a stockholders' action] the directors and stockholders have exercised their business judgment and the proposition before the court is, not whether they have acted wisely but whether they have acted fraudulently. The distinction between the two cases is so plain that it does not merit elaboration."[10]

[10] *Cf. In re Birchall* (1880), 16 Ch. Div. 41, where the Vice Chancellor had forced a settlement upon an infant over the objection of the infant's guardian. The Court of Appeal reversed

Even Congress may not impose non-judicial duties upon federal constitutional courts. *Keller* v. *Potomac Electric Co.*, 261 U. S. 428.[11] This case and the later cases of *Radio Commission* v. *General Electric Company*, 281 U. S. 464 and *Porter* v. *Investors Syndicate*, 286 U. S. 461, illustrate the type of power held by this Court to be non-judicial, and show that the power assumed below was *a fortiori* of this forbidden kind. It is not to be presumed that this Court has exercised its rule-making power to confer upon the lower federal courts a non-judicial power which Congress could not have conferred, or even to have made a rule of doubtful constitutional validity.

(3) *The decision of the Court below ignores the rule of Erie Railroad* v. *Tompkins*, 304 U. S. 64, *and reaches a decision contrary to local law.*

The validity of a release obtained by a fiduciary from his *cestui* is, under the *Erie* rule, governed by state law. *Cohen* v. *Beneficial Industrial Loan Corporation, supra*, 337 U. S. 541, 556, teaches that Rule 23 leaves unimpaired the applicability of state law. *Upson* v. *Otis, supra*, 155 F 2d 606, 610, holds that the state law that governs in the derivative suit must be looked to in a Rule 23(c) proceeding for approval

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with a sharp opinion by Jessel, the gist of which is contained in the following comment from the bench, by Cotton, during argument: "This is not approving a compromise but compelling one. What jurisdiction has the Court to do so?"

[11] *Cf. Eisenlohr* v. *Kalodner*, 145 F. 2d 316, 318 (C. A. 3), cert. den. 325 U. S. 867, where, in discussing the power of the District Court to prevent the termination of, and order an investigation in, a stockholders' derivative action, the Court said, "The fundamental proposition which probably no one would dispute is that a court's power is judicial only, not administrative or investigative."

of a proposed settlement. No state has been stricter than New York, where the settlement was negotiated, in holding that a fiduciary may not be effectively released from claims by his *cestui* unless he makes the fullest disclosures. *Matter of Ryan,* 291 N. Y. 376, 417. The law of the forum, Michigan, is in accord. *Roberts* v. *Michigan Trust Co.,* 273 Mich. 91, 121; *Baxter* v. *Union Industrial Trust & Savings Bank,* 273 Mich. 642, 645. Accordingly, the result below can be sustained only upon the theory that Rule 23(c) has given to federal courts not only a grant of non-judicial power, but also an exemption from the *Erie* doctrine when that power cuts across state law; since the Rule, as interpreted below, gives the federal District Court the power to validate settlements which state law declares to be invalid. Even if Rule 23 constitutionally confers upon federal District Courts the status and powers found by the majority below with respect to federally created rights, we submit that this power can not be used to release rights created by state law when state law invalidates the release on account of fraud in the bargaining.

(4) *The decision below was an abuse of discretion that should be corrected by this Court in order to maintain sound law and policy in the administration of justice by federal courts in this important field.*

The operative facts in the case at bar are: (a) adjudicated breaches of fiduciary duty by corporate directors and managers; (b) adjudicated probability of large recoveries for such breaches and strong indications that if the stockholders are allowed to try their claims there may be a recovery upon an additional cause of action, the Permanente claim, of suf-

ficient magnitude to make the settlement indefensible even in the opinion of the judges who have approved it; (c) fraudulent settlement of these causes of action; (d) consideration for such settlement, for the most part intangible and not susceptible of dollar evaluation; and (e) approval of the settlement by a Board disqualified for self-interest. The District Judge disregarded these circumstances in an exercise of business judgment of dubious providence.

Such a result represents an "exercise of discretion" that passes reasonable bounds. The case at bar is a perfect illustration of the reason for the insistence of courts heretofore upon fairness in the negotiations as a condition to the validity of the settlement. In negotiating any settlement of disputed claims there is practically never a single figure which alone is fair. There is always a range of figures of greater or lesser degree within which a permissible bargain can be reached as a result of informed, fair arms-length bargaining. That is why the court's judicial duty is dual: (i) to see that the bargaining is fair; (ii) to determine whether the figure reached through such bargaining is within permissible limits.[12] If the court omits to make the first determination and approves the settlement without regard to the

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[12] A comparable problem is presented in labor cases where a union bargains for both union and non-union employees. In such cases this Court has said that: "A wide range of reasonableness must be allowed a statutory bargaining representative in serving the unit he represents subject always to complete good faith and honesty of purpose in the exercise of its discretion." *Ford Motor Co.* v. *Huffman* (April 6, 1953), 97 L. ed. 599, 603. In a prior case, *Steele* v. *Louisville & N. R. Co.*, 323 U. S. 192, where the bargaining agent had not bargained fairly on behalf of all, the agreement with the employer was set aside. It was not suggested that the vice of unfair bargaining might be cured by having the court or the National Labor Relations Board sit in as a "third party to the bargain."

kind of bargaining that produced it, it opens the door to transactions of the kind that equity prohibits as a matter of fixed principle, not because they are "always corrupt but because they are always corrupting". *Mosser* v. *Darrow,* 341 U. S. 267, 271. Also, in so doing, the court as a practical matter deprives the *cestui* of his opportunity to get the maximum settlement rather than the minimum. Accordingly, if there could be a case in which the court may ignore unfairness in bargaining it could only be one in which he determines that the *cestui* has received the maximum settlement anyway. Even if such a determination could ever be made, it was not made, and could not possibly have been made, in this case.

In this connection it is instructive to note the consistent practice of the Securities and Exchange Commission which has had occasion, in the course of its quasi-judicial duties of approving reorganizations of companies subject to the Public Utility Holding Company Act, to pass on the settlement of more major corporate controversies than perhaps any tribunal in the country. The Commission always follows the practice of insisting first that there shall have been fair, arms-length negotiation and only then approving the results, if deemed within a proper range. See, for example, *In the Matter of General Gas & Electric Corporation,* 20 S. E. C. 50, 72. This recognition, on the part of an administrative body which may well claim considerable expertness in the decision of what is in the best interest of the company, that the first and indispensable prerequisite for a fair bargain is honesty in negotiating it, confirms the wisdom of similar self-restraint by the federal courts in the interpretation of Rule 23(c), and supports the unlikelihood that this Court intended otherwise in pro-

mulgating the Rule. Lack of such self-restraint in the District Court, approved by a majority below, has resulted not only in disregard of applicable law but in directing the release of meritorious claims, admittedly worth millions, on the evaluation by the Court below of the corporation's "chance to live."[13] Such an appraisal is for all practical purposes unreviewable because no judicial canons exist by which it may be reviewed. Nothing in the special training or usual experience of the judiciary suggests that it possesses such commanding business judgment as to justify setting up district judges as super-boards of directors. This Court, it is respectfully submitted, should review a decision which confers such extraordinary and unreviewable powers upon the federal District Courts.

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[13] The unhappy result when courts undertake to use "business judgment" instead of following the law is illustrated by the history of Kaiser-Frazer following the settlement. It appears that of the total losses suffered by the company as heretofore pointed out, over $45,000,000 was lost since Henry Kaiser gave it the "chance to live" in October 1949. By the end of 1952 the company owed over $53,000,000 and its stock equity was virtually eliminated. In the first quarter of 1953 operations resulted, according to Mr. Edgar Kaiser, in an estimated net loss of an additional $3,100,000. *Cf.* Ex. 173, 3-935 ex., the 1952 Annual Report of Kaiser-Frazer, and article in The Wall Street Journal, April 27, 1953, p. 8.

Prayer.

For the foregoing reasons, petitioners pray that this petition be granted to the end that this case may be reviewed and determined by this Court; that the judgment of the Court of Appeals be reversed; and that the petitioners be granted such other and further relief as may be proper.

Respectfully submitted,

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APPENDIX.

I. Fraud in the Settlement.

Status of the Litigations at the Time of Settlement.

The original plaintiffs, who are petitioners herein, owned collectively over 11,000 shares (R. 1-233-4). Their litigations included all nine claims eventually released in settlement; and at the time of the settlement they had made considerable progress in these litigations. Service in their actions had been made upon all defendants. The complaint in one action had been sustained (*Stella* v. *Kaiser,* 82 Fed. Supp. 301, the suit based on the manipulative stabilization); and this action was to be reached for trial at an early date. A deposition had been taken in one action; in another defendants' attorneys had agreed to produce for examination some of the principal defendants including Henry Kaiser, and depositions were imminent; and in still another depositions had been noticed but had been stayed on application of defendants (R. 1-176-179).

The settling stockholders were Pergament and his cousin, Dr. London. Pergament had purchased his 300 shares of Kaiser-Frazer stock after all the above claims had arisen except the claim based on manipulative stabilization, and his position in the litigation was therefore insecure; prior to settlement, the District Court had held that he was not eligible to sue except with reference to the manipulative stabilization claim (R. 1-99, 100). Dr. London, his cousin, owned 8 shares of stock, and had become a plaintiff at the request of Pergament and upon Pergament's assurance

that he would not have to pay any part of the expenses of litigation (R. 8-4231, 4232, 4237, 4238).

At the time settlement negotiations began, the Pergament-London complaint covered adequately the Graham-Paige claim, discussed by Judge Allen at R. 9-4749-52, and inadequately the manipulation claim, discussed at R. 9-4764-7.[1] The claim as to Permanente, discussed at R. 9-4752-6 and 4759-62, was added by amendment following the institution of the Permanente suits by petitioners herein, but was limited to one plant and omitted other plants sought to be recovered by petitioners. Respecting these causes of action Pergament and London were second or third in the field. Their complaint, even as amended, omitted all mention of the remaining six claims later included in the settlement, including the Fleetwings door claim and the Muntz claims held below to have merit (R. 9-4736). The Fleetwings claim, and three of the four claims held below to be without merit, were asserted by amendment three days before the settlement agreement was signed. The remaining two claims, including the meritorious Muntz claim, were never pleaded but were given away under the general release included in the settlement as negotiated.

The two principal individual defendants, Henry Kaiser and Joseph Frazer, had not been served in the Pergament-London suit at the time of settlement. Service had been secured upon Permanente, a nonresident corporation, through its selling agent in

[1] The Pergament-London complaint failed to include allegations of fact and law on which petitioners had secured a favorable result in another jurisdiction in *Stella* v. *Kaiser*, 82 Fed. Supp. 301, *supra*. During the settlement negotiations counsel for Pergament and London said he thought this claim "was a very weak cause of action" (R. 3-925); and such counsel maintained this position throughout the subsequent proceedings. The Court of Appeals disagreed.

Michigan; and such service had been sustained only tentatively and subject to reexamination at the trial upon a fuller factual showing (R. 1-99).

The Settlement Negotiations.

Settlement negotiations were conducted between Messrs. Chess and Perlman, attorneys for Pergament and London, and Messrs. Hughes and Brown, attorneys ostensibly representing Kaiser-Frazer and paid by them, but really acting in the interests of the Kaisers and other settling defendants (R. 9-4737-8; 4741-2; 4743). Brown was a director of Kaiser-Frazer and a defendant in the Pergament and other suits. Perlman was admittedly uninformed and Chess not appreciably better informed respecting the merits of the claims settled (R. 9-4742), particularly the meritorious Fleetwings claim, which was only inserted in the Pergament complaint by way of amendment three days before the settlement.

In September 1949, when it became fairly clear that the RFC would grant Kaiser-Frazer some sort of a loan, Henry Kaiser and his advisers set about to find a way to use the guaranty as a means for getting released from the claims asserted in the stockholder suits. Toward the end of that month, Hughes sent for Chess. He questioned Chess and satisfied himself that Chess would not be unfriendly. He got Chess to stand by for a settlement offer and persuaded him to refrain from taking or trying to take depositions in the meantime. All this was done under a pledge of secrecy of unexampled character: Chess and Perlman were "forced to conceal from all other attorneys and from their own associates the fact that there was any possibility of settlement" (R. 9-4741). The exclusion of other at-

torneys was admittedly aimed at counsel for these petitioners (*ibid.*); and the exclusion of the better informed associates of Chess and Perlman had the further result that Brown and Hughes limited their opposite numbers in the bargaining to Perlman and Chess, both of them uninformed. Judge Allen noted (R. 9-4742) that Perlman "frankly said he could not evaluate" the claims, that "Perlman's office associates were acquainted with the claims but Perlman was forbidden to discuss them," and further that in the negotiations evaluation of the claims by Chess and Perlman "was completely wanting both with reference to the causes of action upon which the negotiation was based and those added by amendment."

Hughes succeeded in dissuading Chess from taking depositions. He got him to accept instead a briefing by Brown. As noted by Judge Allen, Brown testified "that in these negotiations with Chess and Perlman his effort was to get the easiest possible terms of settlement for the individual defendants and Graham-Paige, and that he, therefore, avoided making disclosures or stating facts, or furnishing information, that would support a recovery for Kaiser-Frazer in these suits. This striking admission was made although Brown's firm was paid by Kaiser-Frazer for these negotiations" (R. 9-4737-8). Judge Allen further notes (R. 9-4740) that "certain facts were, as Hughes admitted, suppressed during the period of negotiation." Some of these suppressed facts are set forth specifically in Judge Allen's opinion (R. 9-4740-1). Additional ones appear in the record.

As a further condition, Chess was required to amend his complaint so as to add to it the claims pleaded by other plaintiffs but omitted by Pergament and London. This was done concededly to get rid of these claims

through the projected settlement, the terms of which had not yet been disclosed to Chess and Perlman. The information for the amendment was furnished by Hughes to Chess "to enable him to amend the complaint to include all causes of action so that a settlement if made would conclude all matters involved in any pending stockholders' derivative action" (Pergament-London brief in the District Court, p. 4); and, after Chess had drafted the amendment, he took it over to Hughes, who suggested a change which Chess adopted (R. 7-3857-8). Judge Allen has noted (R. 9-4743) and the majority has not disputed that "It is conceded that the settlement agreement was planned and negotiated by the attorneys for the defendants Henry J. Kaiser, Joseph Frazer and the individual directors who, while nominally representing Kaiser-Frazer, admitted that they were acting adversely to its interests. These attorneys picked the suit that they would settle, with its friendly lawyers, and by amendment inserted in the suit causes already pending in three federal courts in other states and in three state courts. The adversary relationship essential to protection for Kaiser-Frazer was thus seriously impaired if not destroyed."

It is plain that the conduct of Pergament's and London's counsel in the negotiations was but a faithful reflection of the position of their clients. Pergament, disqualified, and London, indemnified in order to get him to act as an accommodation party (*supra,* pp. i-ii), did not meet the requirement that persons suing in a representative capacity must "fairly insure the adequate representation of all" (Allen, *J.,* R. 9-4743). The degree of care exercised by Pergament and London is indicative of their real position in the litigation. The terms of settlement were first

told Pergament on the night he signed the agreement; and the process of reading the agreement and having it explained to him consumed some fifteen or twenty minutes (R. 8-4207). Dr. London originally testified that he first learned about the settlement (which was dated October 25, 1949) from reading about it in The New York Times dated November 11, 1949 (R. 8-4232; physical Ex. OS-49). Upon his recollection being refreshed by his counsel, he stated that he probably knew about it on or about October 25, when he signed it, but that he did not really understand it until he read about it in the Times (R. 8-4234-6). He further testified that he had a patient in his dental chair at the time he signed the settlement agreement (R. 8-4238-9).

It was such a settlement, so negotiated and agreed to, that, in the words of Judge Allen (R. 9-4745) "sent the case to the District Court with the objecting stockholders carrying an unfair burden. In all but two of the causes of action pleaded, . . . the burden of proof would have been on the directors. . . .Here the burden was in effect placed on the stockholders. Causes of action which had been completely ignored in the settlement were lumped together, [and were] presented to the District Court as a *fait accompli*. . . ."

II. The Settlement.

(a) *The Claims Held Good Below.*

These arose out of the following transactions:

(1) The Graham-Paige transaction, in which Kaiser-Frazer purchased the automotive assets of Graham-Paige upon such terms that the District

Court found that the claim would "meet with considerable favor by the court and jury to which it would be presented" (R. 1-263). The District Judge did not fix the amount of the damages, but petitioners, after applying the evidence to the opinion of the Court, compute it at from $1,218,750 to $2,625,000 without interest.[2] The majority of the Court of Appeals did not disagree that the claim had merit, but they were not convinced "that recovery could be had in any amount determinative of this controversy" (R. 9-4764). Judge Allen thought that a reasonable recovery upon this claim would be $3,914,000 and that such recovery "might well be doubled" (R. 9-4752).

(2) The Fleetwings transactions, involving the purchase by Kaiser-Frazer of automobile doors and deck lids from Kaiser-Fleetwings, Inc., a company owned and controlled by the Kaiser interests. The District Court expressed skepticism as to the Kaisers' justification of the door contract (R. 1-266-7), and held that the claim had certain merit, but he held that the claim with respect to the deck lid contract was without merit. Again, the District Judge did not fix the amount of damages, but upon the evidence as applied to his opinion the petitioners compute the damages at from $1,032,437.86 to $1,381,474.06, exclusive of interest. The majority of the Court of Appeals considered that, if the District Court "was right upon the value of the consideration given for the settlement, any possible recovery on the door contract should not affect the determination of the controversy" (R. 9-

[2] The basis of our computation respecting the first two claims discussed sufficiently appears from their discussion by Judge Allen (R. 9-4747-52). The next two claims discussed are self-explanatory.

4763), and held as to the deck lid contract that the finding of the District Court "is based on substantial evidence and is not clearly erroneous" (*ibid.*). Judge Allen thought that "A substantial recovery on both items is probable and the amount probably recoverable is around $1,600,000" (R. 9-4749).

(3) The manipulation-stabilization claim arising out of the purchase by Kaiser-Frazer of 186,200 shares of its own common stock at $13.50 per share on February 3, 1948, in a vain attempt to stabilize the market at that figure in preparation for a new stock offering. Immediately prior to the stabilization the stock had advanced over 20% following statements put out by Frazer as to Kaiser-Frazer's earnings, which statements in another litigation have been found to be materially untrue and misleading. *Kaiser-Frazer Corporation* v. *Otis & Company,* 195 F. 2d 838, *cert. den.* 344 U. S. 856.[3] The District Court found that this claim had "absolutely no merit . . . from any angle—except as a smoke screen" (R. 1-270). The Court of Appeals disagreed and said: "While we think that the court was in error in assigning no recovery upon this transaction the amount of recovery is so uncertain that the claim asserted by the objectors can have no substantial effect upon the fairness of the compromise" (R. 9-4767). The Court of Appeals held, however (*ibid.*), that the damage was measured by the difference between the price of $13.50 a share paid for

[3] As the majority below stated (R. 9-4765) "under criticism of the S. E. C. by a subcommittee of the Committee on Interstate and Foreign Commerce, 82d Congress, dated September 5, 1952, the S. E. C. states categorically that the Commission and its staff were imposed upon and misled with respect to the Kaiser-Frazer registration statement".

186,200 shares and the value at the time of trial; and, since the market price is now less than $4 a share, the present recovery on this claim would probably exceed $1,700,000.

(4) The Muntz deal, in which Frazer and his associates received secret profits from a retail automobile dealer in a transaction respecting the dealer's agency in which Kaiser-Frazer lost substantial sums. The District Court held that there was probable liability and the Court of Appeals did not disagree. The amount involved was $85,000.

In summary, the above claims had, under the facts as found by the District Court, probable principal value from $2,300,000 to $4,100,000 in round figures. The majority of the Court of Appeals added another $1,700,000 for the manipulative stabilization claim, bringing the total to from $4,000,000 to $5,800,000. Judge Allen estimated probable liability upon the Graham-Paige and Fleetwings claims at $9,000,000 (R. 9-4752); adding to this $1,700,000 for the manipulative stabilization would bring the total liability on these claims, according to her, to $10,700,000. Interest on these sums would increase the recoverable totals very materially.

The foregoing accords no value whatsoever to the multi-million Permanente claim, as to the merits of which the majority and minority below differed sharply, and to which we now turn.

(b) *Permanente.*

The District Court found that the magnitude of this claim was such that if it was meritorious the

settlement would have to be disapproved (R. 1-275). Judge Allen agreed (R. 9-4755, 4756) and the majority did not disagree. The majority below could, however, perceive "no possible recovery" on this claim (R. 9-4762). Accordingly, if there is any merit in this claim, the abuse of discretion below is manifest. *Cf. Taylor* v. *Standard Gas & Electric Co.*, 306 U. S. 307.

This claim arose out of the transfer by Kaiser-Frazer to Permanente Metals Corporation, 65% of the stock of which was owned by the Kaiser interests, of a contract between Kaiser-Frazer and the United States Government under which Kaiser-Frazer was entitled to lease on favorable terms the potentially enormously profitable aluminum rolling mill at Trentwood, Washington. The Permanente claim is discussed by Judge Allen at R. 9-4752-4756 and by the majority at R. 9-4759-4762. Briefly stated, the facts are as follows: On February 19, 1946, Kaiser-Frazer obtained from the Government a preliminary letter of intent, and on March 27, 1946, obtained and accepted a definitive letter of intent (Ex. 17, 1-1 ex. and 6 ex.), covering the Trentwood lease, which obligated the Government to lease Trentwood to Kaiser-Frazer on stated terms. On March 12, 1946, the Board of Kaiser-Frazer, dominated by Kaiser, agreed to transfer this contract to Permanente for no consideration except the assumption of rent and a contract to supply up to 40% of Kaiser-Frazer's aluminum requirements at competitive prices (Exhibit 28—1-77 ex.). Due to lack of funds and internal disagreement, Permanente could not have secured the contract from the Government when Kaiser-Frazer obtained it; and it remained unable to, and did not, take

over the contract until May 25, 1946. Accordingly, Kaiser-Frazer obtained the contract to lease Trentwood by the use of its credit and facilities, carried the contract for about three months until Permanente was able to take it over, with no assurance, in the meantime, that Permanente ever would take it over, and then turned it over to Permanente for no profit and for no substantial consideration.

The majority could perceive "no possible recovery" on this claim (R. 9-4762) because they followed the District Court in accepting various reasons advanced by the interested directors in an attempted justification of Kaiser-Frazer's change of plan. Judge Allen considered the claim meritorious. She followed the leading case of *Irving Trust Company* v. *Deutsch,* 73 F. (2d) 121, 124, C. A. 2, *cert. den.* 294 U. S. 708, the essence of which is as follows: directors may accept or reject for the corporation a business opportunity presented to it; but once they have embarked the corporation upon the venture "they may not substitute themselves for the corporation any place along the line and divert possible benefits into their own pockets."[4]

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[4] The reason for this prophylactic rule in trust relationships is thus stated by Judge Learned Hand in *Morgan Stanley & Co.* v. *SEC,* 126 Fed. (2d) 325, 332: ". . . It is notoriously difficult to ascertain just what motives prompt an act—the actor is often the worst witness—and it is legitimate to avoid such a treacherous issue even at the expense of condemning transactions, blameless if the whole truth could be known. Indeed, the whole law of fiduciaries is built upon just the difficulty of learning the truth with the crude means available. It recognizes the fallibility of any conclusion, but considers the evils that will be prevented as outweighing the limitations imposed upon otherwise lawful conduct. . . ."

The same thought is more succinctly expressed by Mr. Justice Jackson in *Mosser* v. *Darrow,* 341 U. S. 267, 271, where he states

One other phase of this decision is deserving of mention. By the settlement in Michigan, petitioners were deprived of their right to have the Permanente case determined on the merits in Delaware where the established precedents are extremely favorable to plaintiff.[5] In evaluating the Permanente claim, the court in Michigan completely ignored Delaware law. The question arises whether such a forced transfer of the litigation from a Delaware state court to a Michigan federal court, coupled with the complete ignoring of Delaware law in evaluating the claim, is consonant with the *Erie* doctrine.

(c) *Consideration Moving to Kaiser-Frazer.*

For giving up the claims above described, Kaiser-Frazer was to receive the following:

(1) $500,000 in cash. This was to be paid by Permanente alone, although the settlement agreement did

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that equity forbids transactions which may lead to a conflict of interest between trustee and *cestui* not because they "are always corrupt but because they are always corrupting". It is again expressed in *Ashman* v. *Miller*, 101 F. (2d) 85, 91, where the Court below, speaking through a different bench, said: "If two inferences may be drawn from the conduct of the directors in procuring for themselves the voting trust certificates, one without damage to [the company] and the other with it, the latter rather than the former will be drawn because of the relationship of the parties."

[5] Delaware follows the "strict rule" which holds contracts with interested officers and directors voidable at the will of the company unless ratified by a disinterested and undominated majority. *Keenan* v. *Eshelman*, 23 Del. Ch. 234, 2 A. 2nd 904; *Italo-Petroleum Corporation of America* v. *Hannigan*, 14 A. 2nd 401; *Bovay* v. *Byllesby & Co.*, 27 Del. Ch. 381, 38 Atl. (2) 808, 813. The rule of the *Deutsch* case, *supra*, p. xi, was also expressly approved in the leading Delaware case of *Guth* v. *Loft, Inc.*, 23 Del. Ch. 255, 5 Atl. (2) 503, 511.

not so recite and the attorneys for the settling stockholders were not so informed until the matter was brought out in Court by the objecting stockholders.

(2) The purchase by Fleetwings from Kaiser-Frazer of certain presses, belonging to Kaiser-Frazer but installed in the Fleetwings plant, at their depreciated book value of $879,503.30. However, it came out during the hearings that Fleetwings was buying the presses because they were to be included under a $4,500,000 industrial mortgage covering plant and equipment which Fleetwings had been negotiating with Metropolitan Life Insurance Company long prior to the settlement, and which was consummated during the first week of the hearings (R. 2-587).[6]

(3) The guaranty by Henry Kaiser and his associates, to the extent of $15,000,000, of a $44,000,000 long-term loan from the RFC to Kaiser-Frazer and the pledge by them of $10,000,000 of collateral to secure the loan. However, the same parties were already guarantors upon a $16,000,000 short-term loan then in default and, since Kaiser-Frazer was admittedly in danger of liquidation (R. 9-4736), they were acting only in self-protection. Counsel for the settling stockholders were told that, unless they settled, the Kaisers would let Kaiser-Frazer go into liquidation (R. 7-

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[6] These were among the facts suppressed in the negotiations. The attorneys for the settling stockholders learned them for the first time during the hearings (R. 2-583-587; also 6-3533), when the objecting stockholders, who had ascertained them through independent research, spread them on the record. At that time the District Court expressed doubt whether this purchase constituted *bona fide* consideration, and he observed that the proponents' failure to disclose the facts to him "would almost amount to a misrepresentation to the Court" (R. 2-589-90).

3975). This was an implausible threat on its face. At this time, largely on the strength of the Kaiser name, the public had been procured to invest some $50,000,000 in Kaiser-Frazer; and the threatened liquidation would have involved the Kaisers in a nation-wide scandal. The fact that the Kaisers gave the guaranty before the settlement was approved by the Court throws further doubt on the sincerity of this threat (R. 9-4737). In fact, Kaiser-Frazer drew down $19,000,000 of the RFC loan before filing the petition to approve the settlement (Exs. 134, 137, 2-796 ex., 808 ex.). An unrehearsed statement of Kaiser's real motivation in giving the guaranty is found in a letter dated January 25, 1950, in which a Mr. Houser, one of Kaiser's fellow-directors on the Kaiser-Frazer board, said to an inquiring stockholder:

> "Although the Kaisers own some 10% or less of the stock, they pledged security for loans of some $15,000,000, not because there was any obligation to do so, *but because Mr. Kaiser felt he could not afford to have a major failure against his reputation*" (Emphasis ours; Ex. OS-61, 3-1320 ex.).

The District Court refused to find that Kaiser would have carried out his threat (R. 1-249, 50). Nevertheless, the attorneys for the settling stockholders immediately yielded to the threat and rushed into a settlement.[7]

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[7] Chess and Perlman accepted the statement of Hughes "that under no conditions would Mr. Henry Kaiser allow his companies to guarantee the RFC loan . . . unless these suits were settled" (R. 7-3975), and believed that "the secured guaranties alone, in the life or death crisis confronting K-F would constitute an adequate consideration" (Brief of settling stockholders in the Court of Appeals, p. 13).

Judge Allen thought that the consideration was inadequate even assuming *arguendo* "that Kaiser-Frazer received the equivalent of $5,100,000 in the settlement". The majority, like the District Court, attempted to place no dollar value on such consideration; they mentioned various figures, but came up with no total.[8] They thought it sufficient that the guaranty gave Kaiser-Frazer "a chance to live". They wrote (R. 9-4770): "The chance to live and not Trentwood was Kaiser-Frazer's opportunity, even though it should ultimately fail,—and it may not fail."

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[8] The majority found, in addition to the $500,000 in cash "nearly $900,000" of consideration in the sale of the presses (R. 9-4768). Since the amount Kaiser-Fraser received for the presses was less than $880,000 and they had a recoverable value of $560,000 it would seem that the net gain to Kaiser-Frazer was nor more than $320,000. This was all that the settling stockholders claimed (R. 2-583). Respecting the value of the guaranty the majority, and also Judge Allen referred to a letter from an agent of Lloyds of London which stated that a fair premium for the guaranty would be $3,750,000 (R. 9-4769). However this letter was received by the court not as proof of value but only to show that the Pergament-London attorneys had received such a letter (R. 6-3477-80). No proof was made as to the facts given to Lloyds or the basis on which Lloyds arrived at its figure.

The majority also referred to another figure of $20,000,000 as representing the testimony as to the value of the guaranty which the District Judge might well have accepted (R. 9-4769). This figure is supposedly taken from the testimony of an accountant who testified, as the majority stated, that the value of the guarantee was, in his opinion, one-fifth or one-fourth of the common stock of Kaiser-Frazer; but he did not add that such fraction equals $20,000,000, which would have given a total value of $80,000,000 to $100,000,000 for a company that at that very time "faced the threat of liquidation" (R. 9-4736). In their brief in the District Court (p. 14), Pergament and London said that the value based on the accountant's testimony would be $4,600,000 to $5,750,000. The basis of this calculation is not stated in the brief, but the figures given are in line with the then current market value of Kaiser-Frazer stock.

IN THE

Supreme Court of the United States

October Term, 1956.

No. 133

JAMES F. MASTERSON, MICHAEL STELLA, EVA LEFKIER and OTIS & COMPANY,

Petitioners,

vs.

JEROME B. PERGAMENT and GEORGE J. LONDON, et al, JOSEPH W. FRAZER and HENRY J. KAISER, et al.,

Respondents.

BRIEF OF JEROME B. PERGAMENT AND GEORGE J. LONDON IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI.

THEODORE R. KEYES,

SAMUEL A. GOLDEN,

RICHARD J. HECHT,

KENNETH FISCHER,

Counsel for Respondents Jerome B. Pergament and George J. London.

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Respondents.

BRIEF OF JEROME R. PERGAMENT AND GEORGE J. LONDON IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI.

Questions Presented.

The five questions presented by petitioners are but subdivisions of one principal question which is predicated upon a false assumption contrary to the decision which is sought to be reviewed. The question is therefore nonexistent.

Court Rules Involved.

Rule 23 (c) of the Federal Rules of Civil Procedure.

"(c) DISMISSAL OR COMPROMISE. A class action shall not be dismissed or compromised without the approval of the court. If the right sought to be enforced is one defined in paragraph (1) of subdivision (a) of this rule notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs."

Rule 52 (a) of the Federal Rules of Civil Procedure.

"FINDINGS BY THE COURT. (a) EFFECT. In all actions tried upon the facts without a jury * * * the court shall find the facts specially and state separately its conclusions of law thereon and direct the entry of the appropriate judgment; * * * Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. * * * If an opinion or memorandum of decision is filed, it will be sufficient if the findings of fact and conclusions of law appear therein. * * *"

Rule 38 (2) of the Revised Rules of the Supreme Court of the United States.

"The petition shall contain * * * the questions presented; and the reasons relied on for the allowance of the writ. Only the questions specifically brought forward by the petition for writ of certiorari will be considered. * * *"

Statement.

At the threshold of the consideration of the present Petition for Writ of Certiorari the first inquiry must be, did the Court of Appeals make the decision, the review of which this Court is requested to undertake. To gain entrance to this Court petitioners submit an issue (Pet. 3)[1] which, completely without warrant, assumes that the court below made a decision which it did not make. Therefore, the prayer for the writ should be forthwith denied.

Argument.

The Court of Appeals did not hold that under Rule 23(c) F.R.C.P., a District Court may approve the settlement of a representative suit regardless of constructive fraud in the negotiation of the compromise, but, on the contrary, affirmed the findings of the District Court, made upon substantial evidence and in the exercise of sound judicial discretion, that the compromise "was arrived at fairly and in good faith." Therefore, the assumed question presented to this Court does not exist.

Plainly, the Court of Appeals did not hold, as the instant petition asserts, that a District Judge may, "under Rule 23(c) of the Federal Rules of Civil Procedure, approve the settlement of a stockholders' derivative action regardless of the fact that its negotiation constituted a constructive fraud upon the stockholders of the corporation." (Pet. 3) The entire and actual import of the petition is contained in and confined to the opening paragraph of the "Summary Statement" which states the spurious issue and misstates the actual holding. To place the position of petitioners in quick contrast with the actual holding of the Court of Appeals, this paragraph of the petition is quoted as follows:

> "The issue presented by this petition is whether this Court will review the holding of a majority of the Court

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[1]Record references will be made by volume and page; References to the Petition for Writ of Certiorari will be made by the abbreviation "Pet." followed by the page number.

below that a District Judge may, under Rule 23(c) of the Federal Rules of Civil Procedure, approve the settlement of a stockholders' derivative action regardless of the fact that its negotiation constituted a constructive fraud upon the stockholders of the corporation. The majority below expressly declined to consider the points that 'the negotiators of the settlement on behalf of the corporation (i.e., counsel for plaintiffs in the stockholders' action used by defendants as a vehicle for the settlement) were not fully informed; that material information was concealed from them; that the lawyers participating occupied a dual role; or that there was no arm's-length bargaining' (R. 9-4758). In the majority's view these facts were immaterial, since under Rule 23(c) the settlement agreement could not become effective without approval of the District Judge; the latter 'was therefore a third party to the compromise,'; and, there being no contention that 'important information was concealed from him or that his participation in the settlement was subject to any infirmity,' *antecedent fraud among the other parties to the settlement was of no moment (ibid.)*"[2] (Italics supplied.) (Pet. 2-3)

While the Court said that it would not be led into a discussion of the contentions as to alleged improprieties in the negotiation of the compromise—contentions which related to questions of fact, that is not all the Court said, nor is it indicative of the true content of the opinion of the majority on this issue. As to this question, the District Judge heard the evidence and found against petitioners,

[2]The language "antecedent fraud among the other parties to the settlement was of no moment (ibid)" is inserted as if it were part of the "majority's view". Not only is such language not contained in the opinion itself, it is repugnant to the scope and intent of the complete paragraph of the opinion to part of which, only, petitioners refer.

and the Court of Appeals affirmed the finding. Proceeding under "familiar rules" the Court of Appeals in the concluding sentence of the paragraph under consideration, with decisive finality, stated:

> "In any event, he ruled against the objectors upon these matters, upon the consideration of substantial evidence and in the exercise of sound judicial discretion." (R. 9-4758)

Thus the actual decision is contrary to the proposition which petitioners attempt to write into the Court's opinion upon the assumption of which petitioners base their single ground for review. The Court of Appeals no more definitely could have expressed its satisfaction with the findings of the District Court, or with more clarity have announced its acceptance of the District Court's conclusions. Having thus accepted the findings of the District Judge on the controverted question of fact, it was unnecessary for the Court of Appeals to decide, and it did not decide, what the law would be had there been irregularities in the negotiations.

Throughout the petition it is assumed that petitioners' version of the facts on the issue as to the propriety of the negotiations must be taken as correct and that the majority opinion took it as correct, but, nevertheless, held that the events of the negotiation were "of no moment." This false assumption is inherent in, and is the foundation of petitioners' position. The petition does not, because it cannot, refer to any portion of the majority opinion in which the Court states that it agreed with the inferences of the dissenting Judge as to the facts appertaining to the negotiations. That the Court did not accept petitioners' inferences from the facts, or the view of the dissenting Judge as to this element of the case, is definitely established by the language of the opinion that the hearing Judge decided against petitioners "upon the consideration of *substantial*

evidence and in the exercise of *sound* judicial discretion." On this, the only issue presented by the petition, the majority sharply disagreed with the dissent. Yet this Court is asked to take the case upon the basis of an asserted unanimity of opinion as to the facts on the issues presented.

The District Court found that there was no impropriety in the negotiations.

The reason for the position taken by the Court of Appeals on the subject of the negotiation of the settlement, is found in the opinion and the findings and conclusions of the District Judge. He perceived his duty to be, to use his own language, "* * * to see that the compromise is fair and reasonable under the circumstances, *and that no collusion or fraud has been practiced in the consummation of the settlement.*" (R. 1-238) (Italics supplied) He expressly recognized that an issue which the Court "must necessarily settle before proceeding" to the consideration of the stockholders' claims and the adequacy of the consideration, was the propriety of the settlement negotiations. The District Judge said:

> "Another issue which we must necessarily settle before proceeding is objecting stockholders' contention that the proposed settlement agreement should not be approved because, first, it is not the valid act of Kaiser-Frazer or anybody competent to act for Kaiser-Frazer; second, it was not arrived at by arms-length bargaining in good faith; third, failure to include attorneys for objecting stockholders; and, fourth, there was collusion." (R. 1-236)[3]

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[3]Yet Judge Allen in her dissent said, "The District Court considered that arms-length negotiations are not required for a valid compromise. We think under the instant record this was error of law." (R. 9-4740).

The Court then proceeded to analyze the facts and to discuss the same cases as are relied upon by petitioners here[4] in support of the claim that freedom from fraud in negotiations is a condition prerequisite to any compromise of a derivative or representative action. Referring to these same authorities the District Judge said:

> "These cases are in point and are authority for the legal conclusion that if there's fraud, collusion or unfair dealings on the part of the directors of the corporation in arriving at the settlement the court will set it aside. We have no quarrel with those decisions. *"But here we do not find any collusion, fraud, concealment or unfair dealing in arriving at the compromise* and we hold there was 'arms-length bargaining.'" (R. 1-242) (Italics supplied)

The final order of the District Court approving the compromise and dismissing the suit directly finds that Rule 23(c) had been fully complied with and finds that, "said agreement of settlement and compromise was arrived at fairly and in good faith;" (R. 1-291).

In addition to its language to the effect that it would not disturb the findings of the District Court on the issue of the propriety of the negotiations because that Court decided this question of fact upon substantial evidence and in the exercise of sound judicial discretion, further concurrence in the findings and conclusions of the District Court is found in the end-result of the opinion of the Court, the last paragraph of which affirmatively decides:

> "Giving full consideration to all the circumstances disclosed by the voluminous record in the case, the

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[4]Goodwin v. Castleton, 19 Wash. 2d 748, 144 Pac. 2d 725; Karasik v. Pacific Eastern Corporation, 21 Del. Chan. 81, 180 A. 604; Perrine v. Pennroad Corporation 47 A. 2d 479 (Del.), cert. den. 329 US 808; Feldman v. Pennroad Corp., 155 F. 2d 773 (C.A. 3), cert. den. 329 US 808. Cited to and considered by the District Court (R. 1-241-2). Cited to this Court (Pet. 12).

many arguments presented orally and in the briefs, and the post-hearing communications to the court, we are unable to conclude that the District Judge was clearly erroneous in his major findings, or abused his discretion in his ultimate conclusions." (R. 9-4770)

Findings of fact will not be set aside unless clearly erroneous.

The District Judge had first hand opportunity to see and hear the witnesses who participated in the negotiation of the compromise, and after the most conscientious consideration came to his deliberate conclusions. On the subject of negotiation the evidence was entirely oral in nature. His findings are not called in question, nor is there any reference to the record to show in what respects he erred. With his findings, the Court of Appeals concurred. Petitioners, however, attempt to substitute the interpretations and inferences of the dissenting Judge for the affirmed findings of the District Court. Thereby, this Court, in effect, is requested to decide what inferences should be drawn from the testimony, those of the District Court, unaltered by the majority, or those of the dissenting Judge. The task would require this Court to draw its own inferences, an undertaking which would involve an appraisal of the oral testimony itself, in effect, a trial of this issue, *de novo,* by this Court. This the Court will not do under its own interpretation of Rule 52(a) F.R.C.P. which provides that:

> "Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses."

In considering Rule 52(a), the Court, in *Timken Roller Bearing Co.* v. *United States,* 341 US 593, 596-7, said:

> "For the most part, this shotgun approach is actually only a dispute as to the proper inferences to be drawn from the evidence in the record; in effect, it is an invitation for us to try the case de novo. This

Court must decline such an invitation just as it does when the Government makes the same request. *United States* v. *Yellow Cab Co.*, 338 US 338, 94 L ed 150, 70 S Ct 177. In the present case, the trial judge after a patient hearing carefully analyzed the evidence in an opinion prepared with obvious care. Appellant's lengthy brief has failed to establish that there was error in making any crucial, or even important, ultimate or subsidiary finding. Since we cannot say the findings are 'clearly erroneous,' we accept them."

No question having been specifically raised as to the findings of fact, such findings will not be reviewed by this Court.

No question is presented as to whether or not the findings of the District Court are clearly erroneous. Neither is any question raised as to the conclusions of the Courts below with respect to the value of the stockholders' claims or with respect to the adequacy of the consideration. Hence, as to them, no question is raised for review. It is the policy of this Court to refuse to review questions other than those formally presented by the petition. Rule 38(2), Revised Rules of the Supreme Court of the United States; *General Talking Pictures Corporation* v. *Western Electric Company*, 304 US 175, 177-179; *National Licorice Company* v. *National Labor Relations Board*, 309 US 350, 357 Note.

This Court will not review questions of fact presented under the disguise of a nonexistent question of law.

Realizing that this Court will not take cases for the review of questions of fact, petitioners, to induce this Court to grant the writ, adopt the device of presenting the question to be decided as one of law, upon the feigned hypothesis that the majority of the Court of Appeals "did not take issue" with the views of the dissent as to the facts appertaining to the negotiation of the settlement, "but assuming

them to be true, held that they were immaterial," (Pet. 6). Proceeding upon this assumption, petitioners present an argument into which is interwoven assertions and contentions of fact, not only as to the negotiation of the compromise, but, also, as to the causes of action and the adequacy of the consideration for their settlement, all of which are boldly, but insupportably, stated as "the operative facts in the case at bar," (Pet. 20). Furthermore, in their attempt to draw to the attention of this Court issues and arguments which possess no relevance to the question actually submitted for consideration, petitioners attach an Appendix which touches upon a variety of subjects not properly cognizable under the present application. This "side-entrance" expedient of attracting the Court's attention, with its argumentative, incomplete and slanted statements of fact, cannot be taken to expand the question presented by the petition, and, therefore, it requires no further discussion.

The alleged breaches of fiduciary duty which constitute the basis of the stockholders' unliquidated claims, the nature and adequacy of the consideration for their dismissal, and the negotiation of the compromise proposed to the Court, all involved questions of fact as to which complete evidence was introduced and arguments made and considered by both courts below. Were respondents to counter with a comprehensive presentation of the evidence which denies petitioners' assertions, they would participate with petitioners in violating the admonition of this Court that it will not take, and should not be requested to consider, questions of fact as to which the original court made findings "upon substantial evidence," and in the exercise of a judicial discretion which the reviewing court held to be "sound".

The separation of the principal issue into five special questions as "The Questions Presented," and the arguments addressed to the Court in the "Reasons for Granting the Writ", are all predicated upon the fallacious, single postulate that the Court of Appeals held that fraud in the making of a proposed compromise is "of no moment" in determining the approvability of the settlement of stockholders' derivative actions. Once the falsity of the basic premise is perceived and removed, the resultant collapse of petitioners' entire presentation is inevitable.

The judgment of the District Court, affirmed by the Court of Appeals, was entered on a record comprising over 7,450 typewritten pages, and after the Court had listened to the testimony of 21 witnesses, read 13 additional depositions and examined over 450 exhibits. The principal defendants to the stockholders' suits, the lawyers who negotiated the settlement, and others, were examined and exhaustively cross-examined by counsel for the objectors. Opportunity unprecedented was afforded by the Court to insure complete disclosure of the facts, including all of the facts bearing on the negotiation of the proposed contract of settlement.

The District Judge, hearing all of the evidence, decided that the proposed settlement was fair and equitable and for the best interests of the corporation and all of its stockholders. But before doing so, after hearing all of the evidence thereon, he decided that there was nothing in the events of negotiation which impaired the validity of the settlement agreement submitted for consideration. As stated in *Koster* v. *Lumbermens Mutual Casualty Co.*, 330 US 525-6, in construing Rule 23(c), "Thus, such a litigation brings to the court more than an ordinary task of adjudication; it brings a task of administration * * *." The task imposed upon the court under Rule 23(c) requires the

exercise of true judicial function which, it is submitted, was performed by the District Judge competently and with sound judicial discretion. In the instant case the Court of Appeals, like this Court in *United States* v. *Yellow Cab Co.*, 338 US 338, 340-1, rationally and realistically recognized that, "The judgment below is supported by an opinion prepared with obvious care which analyzes the evidence and shows the reasons for the findings. To us it appears to represent the considered judgment of an able trial judge, after patient hearing * * *."

Conclusion.

The propriety of the negotiation of the proposed settlement agreement was a question of fact which was determined by the District Judge, a decision which the Court of Appeals recognized as being grounded upon substantial evidence and made in the exercise of sound judicial discretion. The Court of Appeals did not decide that the proposed settlement of a stockholders' suit may be approved regardless of improprieties or insufficiencies in its making. Therefore, the ground upon which this Court is requested to grant the Writ of Certiorari does not exist.

The prayer of the petition should be denied.

Respectfully submitted,

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No. 185

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In The

Supreme Court of the United States

October Term, 1952

JAMES F. MASTERSON, MICHAEL STELLA, EVA LEFKER and OTIS & COMPANY,

Petitioners,

vs.

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Respondents.

BRIEF OF RESPONDENT KAISER ALUMINUM & CHEMICAL CORPORATION (formerly known as Permanente Metals Corporation) IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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Respondents.

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OPINIONS BELOW

The opinion of the District Court, approving the settlement, was filed August 11, 1950 (R. 1-233) and is reported in 93 F. Supp. 13. The opinion of the Court of Appeals, Judge Allen dissenting, affirming the District Court, was filed March 23, 1953 (R. 9-4732) and is reported in 203 F. (2d) 315.

JURISDICTION

Jurisdiction of this Court is sought to be invoked under Section 1254 of Title 28 of the United States Code. The judgment of the Court of Appeals was entered March 23, 1953 (R. 9-4731).

STATEMENT

As to the Permanente claim, the District Judge stated in his opinion that it was the most important only because it asserted the largest amount of damages and that if there was a probability of the stockholders recovering the "near maximum of what they claim" the consideration specified in the settlement agreement was not enough (R. 1-275). The District Judge further stated that even if the stockholders were successful in the Permanente suit, recovery would be limited to an amount amply covered by his interpretation of the value of the consideration in the proposed settlement (R. 1-257). Petitioners' assertion that all judges agreed that if the Permanente claim was meritorious it was of sufficient magnitude, standing alone, to invalidate the settlement for inadequacy (P. 7)[1] is solely the assertion of the dissenting judge (R. 9-4755-6). The District Judge concluded that there was no probability of recovery as to the Permanente claim (R. 1-247, 289). This conclusion was expressly affirmed (R. 9-4762).

1Reference to the petition is indicated by P.; to the record by R.

ARGUMENT

The Issue

Petitioners have neither separately filed a supporting brief nor annexed a brief to their petition, as contemplated by Rule 38. As a result, more than half of the petition is devoted to argument.

Despite this manner of presentation, the determination of the question presented for review is still controlled by the principle stated in *General Talking Picture Corporation v. Western Electric Company*, 304 U. S. 175:

> "Whether included in the petition or separately presented, the supporting brief is not a part of the petition, at least for the purpose of stating the questions on which review is sought."

Applying this principle to the petition and distinguishing between the argumentative (P. 11-24) and the narrative (P. 1-11) portions thereof, it is immediately apparent that, as the briefs of the other respondents demonstrate, the only issue raised by the petition assumes as its basis the existence of fraud in the negotiation of the settlement agreement. This respondent will not burden this Court with a repetition of the observations of the other respondents concerning the nonexistence of this basic premise of the petition. The inescapable facts are that the District Judge found the settlement was free from fraud (R. 1:242) and was arrived at fairly and in good faith (R. 1:291), which findings the majority of the Court of Appeals properly affirmed as based "upon the consideration of substantial evidence and in the exercise of a sound judicial discretion" (R. 9:4758). Petitioners' claimed issue is not presented, but is refuted, by the record which plainly negatives their basic assumption. Their petition ignores the findings of the

District Judge, as affirmed by the Court of Appeals, and substitutes almost exclusively contrary recitals from the dissenting opinion. In their references to the Permanente claim (involving this respondent) this same pattern is followed.

Permanente Claim

None of petitioners' Questions Presented and none of petitioners' Reasons for Granting the Writ involve the Permanente claim or seek review of the affirmed finding that it involved no probability of recovery.

However, in the Appendix to their petition and in an effort to bolster up their charges of fraud and unfair dealing, petitioners attempt to portray the claim against Permanente as a claim of great magnitude and potentiality which was settled for a trifling consideration. The inference is, of course, that a settlement disposing of such a valuable claim must have been fraudulent and for inadequate consideration.

The magnitude and potentiality which petitioners ascribe to the Permanente claim is contrary to the record. The District Judge in his opinion classified it (involving as it did the Trentwood rolling mill) as one of the claims as to which

> "there would in all probability be no recovery by the objecting stockholder plaintiffs * * *" (R. 1:247).

In the appendix to his opinion, the District Judge extensively reviewed the facts with respect to the claim (R. 1:275-289) and concluded:

> "* * * it is my belief that this transaction would not be set aside by any court or jury. We find absolutely no merit to objecting stockholders' contentions in the Permanente suit." (R. 1:289).

Upon appeal, the dissenting judge, after reviewing *some* of the facts concerning the Permanente claim, expressed

the view that the District Judge was mistaken in his appraisal of the claim (R. 9:4752-6). However, the majority of the Court of Appeals concurred with, and affirmed, the District Judge. After commenting that the dissenting opinion "accurately recites some of the circumstances * * * *but does not give the whole picture*"[2] (R. 9:4759), the majority discussed at considerable length the numerous important elements of the Permanente case which had been considered by the District Judge but ignored in the dissenting opinion and concluded:

> *"We perceive no possible recovery upon the claim based on the Permanente transaction."* (R. 9:4762).

The effort of petitioners to build up the appearance of a large potential recovery on the Permanente claim is unsupported by the record. It is founded, as is their assumption of fraud in the negotiations of the settlement agreement, on the dissenting opinion and ignores completely the findings of the District Judge which were affirmed by the majority.

The factual assertions and the arguments of petitioners are patently based on a failure to recognize that the majority of the Court of Appeals concurred in the statements of the dissenting judge only in certain specific and limited respects. The majority opinion states in its opening paragraph that, in view of the elaborate dissenting opinion, it became unnecessary to review what was said therein

> "as to the origin of the litigation, the relationship of the parties and circumstances not controverted in the various transactions here challenged * * *." (R. 9:4756)

The majority also concurred in the statement of law requiring meticulous scrutiny of transactions between corporations having overlapping directors and officers.

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[2]Emphasis added unless otherwise noted.

But on the vital question of fraud in the negotiations and on the potentiality of the Permanente claim, the majority of the Court of Appeals expressly affirmed the findings of the District Judge that (1) the negotiation of the settlement was fair, in good faith and free of fraud and (2) that the Permanente claim offered no probability of recovery.

Substitution of contrary statements of a dissenting appellate judge for facts found and determined by a District Judge and, upon substantial evidence, affirmed by the majority of the Court of Appeals is indeed a novel device but, it is respectfully submitted, not a ground for granting a petition for certiorari.

In final analysis, what petitioners seek, and must obtain before the issue which they present becomes pertinent, is a determination by this Court that the underlying facts as to fairness and good faith in the settlement negotiations and as to the potentiality of the Permanente claim should have been found as recited in the dissenting opinion rather than as found by the District Judge and affirmed by the majority. This Court has declined to grant certiorari merely to review the evidence or the inferences to be drawn therefrom where there is evidence to support the findings.

> "They are not to be disturbed unless plainly without support." *General Talking Pictures Corporation v. Western Electric Company,* supra.

It is respectfully submitted that the petition for certiorari should be denied.

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Dated July 14, 1953.

FILED
JUL 20 1953
H. B. WILLEY, C

IN THE

Supreme Court of the United States

OCTOBER TERM, 1952.

No. 133

JAMES F. MASTERSON, MICHAEL STELLA, EVA LEFKER, and OTIS & COMPANY,
Petitioners,

vs.

JEROME R. PERGAMENT and GEORGE J. LONDON, *et al.*, JOSEPH W. FRAZER and HENRY J. KAISER, *et al.*,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT.

BRIEF IN OPPOSITION.

ON BEHALF OF RESPONDENTS JOSEPH W. FRAZER, HENRY J. KAISER, EDGAR F. KAISER, G. G. SHERWOOD, E. E. TREFETHEN, JR., CLAY P. BEDFORD, W. A. MacDONALD, HICKMAN PRICE, JR., and KAISER-FRAZER CORPORATION.

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Opinions Below.

The opinion of the District Court, approving the settlement, was filed August 11, 1950 (R. 1-233)[1] and is reported in 93 F. Supp. 13. The opinion of the Court of Appeals, Judge Allen dissenting, affirming the District Court, was filed March 23, 1953 (R. 9-4756) and is reported in 203 F. (2d) 315.

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[1] References to pages of the printed record will be made as "R." with the volume and page number of the record following. The Petition for Certiorari is referred to as "Pet. p. ".

Jurisdiction.

The jurisdiction of this Court is sought to be invoked under Section 1254 (1) of Title 28 of the United States Code as amended by the Act of June 25, 1948 (Public Law 773; c. 646). The judgment of the Court of Appeals was entered March 23, 1953 (R. 9-4731).

Questions Presented.

Petitioners state (Pet. pp. 2-3) that the issue presented is:

> "* * * whether this Court will review the holding of a majority of the Court below that a District Judge may, under Rule 23(c) of the Federal Rules of Civil Procedure, approve the settlement of a stockholders' derivative action regardless of the fact that its negotiation constituted a constructive fraud upon the stockholders of the corporation."

Likewise, in their statement of "Questions Presented" (Pet. pp. 10-11), petitioners pose a series of questions, each of which erroneously assumes that the negotiations leading to the settlement were fraudulent and that there was "fraud in the *factum.*"

No such issue or questions are involved or presented in this case. The District Court made findings that there was no fraud, collusion or unfair dealing in arriving at the compromise.[2] The Court of Appeals affirmed, noting (R. 9-4758) that the District Judge—

---

[2] The District Judge made specific findings of fact, as follows:

(R. 1-240)

"There is claim also by objecting stockholders (petitioners) that attorneys for plaintiff (Pergament) were in collusion with defendants. We saw no evidence of any such collusion."

(R. 1-242)

"But here we do not find any collusion, fraud, concealment or unfair dealing in arriving at the compromise and we hold there was 'arms-length bargaining.'"

> "* * * ruled against the objectors upon these matters (i.e., petitioners' charges of fraud, collusion and unfair dealing) upon the consideration of substantial evidence and in the exercise of a sound judicial discretion." (Insert ours.)

The decision of the Court of Appeals affirmed the decision of the District Judge in which in the exercise of his discretion he approved the settlement of certain derivative suits as being in the best interests of the Corporation and its stockholders. These decisions present no novel or important questions of legal principle warranting review by this Court nor do they involve any substantial question of construction of any federal law or conflict with any decision of this Court or the decisions of the Courts of Appeal of other circuits. Accordingly, no new question is presented for review by this Court.

Court Rules Involved.

Rule 23(c) of the Federal Rules of Civil Procedure provides in its pertinent provisions:

> "(c) DISMISSAL OR COMPROMISE. A class action shall not be dismissed or compromised without the approval of the court. If the right sought to be enforced is one defined in paragraph (1) of subdivision (a) of this rule notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs."

Rule 52(a) of the Federal Rules of Civil Procedure provides in its pertinent provisions:

> "FINDINGS BY THE COURT. (a) EFFECT. In all actions tried upon the facts without a jury * * * the court shall find the facts specially and state separately its conclusions of law thereon and direct the

> entry of the appropriate judgment; * * *. Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial judge to judge of the credibility of the witnesses. * * *"

Statement.

The "Summary Statement," "Statement" and "Appendix" in the petition are a presentation of alleged facts which are so inaccurate and misleading in so many particulars that to correct them in detail would expand this brief beyond permissible bounds. Accordingly, we shall refer only to such misstatements in the petition as serve to establish its lack of merit.

Petitioners seek review of the judgment of the Court of Appeals affirming the District Court's approval of the settlement of a derivative stockholder's suit pursuant to Rule 23(c) of the Federal Rules of Civil Procedure. The action in which the settlement was made had been pending for a period of over a year and a half in the Eastern District of Michigan, where the Corporation has its offices and plant.

Plaintiffs in this action had been vigorously pressing their action through the pre-trial stages and were virtually ready for trial. Settlement negotiations were commenced with them not because they were "friendly" but because it was believed that they were the only stockholder-plaintiffs litigating in good faith—a belief which the District Court found to be justified after viewing and hearing all parties concerned (R. 1-238-40). A settlement agreement was reached October 25, 1949, which was expressly conditioned upon approval by the District Court pursuant to Rule 23(c) before it should become effective (R. 1-161).

Notice of the proposed settlement was sent to each stockholder of the Corporation a month before commencement of the hearings thereon (R. 1-145). Subsequently a second notice (R. 1-224), prepared by the District Court despite petitioners' refusal to cooperate (R. 1-235-6, 9-4758) and covering matters complained of by petitioners, was sent out even though the District Court was satisfied that the first notice was adequate (R. 1-236).

Pursuant to such notice, hearings were held over a period of thirteen weeks, with adjournments for the taking of such depositions as were desired by any of the parties. During the entire period, the sole objectors appearing were petitioners, whose stockholdings, with the exception of Otis & Co., represented but 345 shares out of more than four and a half million shares outstanding (R. 1-233-4). The stockholders favoring the settlement agreement far outnumbered those against it (R. 1-257).

Throughout the lengthy hearings before the District Court, the proponents of the settlement assumed and bore the burden of proving the fairness of the settlement. They produced witnesses to all the transactions complained of in the various stockholder suits and all documentary evidence requested by petitioners. All of the attorneys who were parties to the settlement negotiations took the stand and were examined and cross-examined extensively. The transcript totaled over 7,000 pages.

As the District Judge observed (R. 1-237-8):

> "From the length of time consumed, the number of witnesses and exhibits, the depositions and the size of the record, it must be axiomatic that if the knowledge of all the attorneys representing the stockholders could have been added together, previous to or after negotiating this agreement, it could not have equaled or approached the facts that are now before this court. * * *"

In considering the settlement, the District Judge conceived his duty to be:

> "To see that the compromise is fair and reasonable under the circumstances, and that no collusion or fraud has been practiced in the consummation of the settlement" (R. 1-238).

He concluded that the settlement was fair, equitable and for the best interests of all the stockholders (R. 1-258); that there had been no collusion, fraud, concealment or unfair dealing in arriving at the compromise and that there was "arms-length bargaining" (R. 1-242). Accordingly, he approved the settlement.

The District Judge exhaustively considered each claim made in the various stockholders' suits then pending. There were nine such claims, eight of which charged self-dealing by the corporation's directors with companies allegedly owned or controlled by the Kaisers or Frazer. The District Court found there was no probability of recovery on six of the nine causes of action. As to the remaining claims, the District Judge summarized his findings by saying (R. 1-247):

> "There might be a recovery of a comparatively small amount on the stock transfer valuation part of the Graham-Paige exchange; also on the Muntz car deal from Joseph Frazer, and possibly a small additional sum from Fleetwings."

As to *all* of the claims and petitioners' charges that the Kaiser and Frazer companies "* * * derived great profits without corresponding consideration to the corporation * * *" (Pet. p. 5) the District Court found after viewing and hearing virtually every witness to the transactions that (R. 1-256):

> "* * * as we have examined these questions we have come to the conclusion and hold that in none of the transactions has there been any fraud, collusion or attempt on the part of the so-called Kaiser interests to benefit at the expense of Kaiser-Frazer. On the contrary, Henry Kaiser has time and again, according to the undisputed facts, come to the rescue whenever the Kaiser-Frazer Corporation appeared to be headed for financial disaster"

Turning to a comparison of the probabilities of recovery with the consideration moving to the Corporation, the District Court concluded (R. 1-255-7):

> "It is our opinion that the consideration here is divided into three phases—all of which are good—the guaranties, the Fleetwings payment, and the $500,000, which add up to a formidable sum of money * * *.
>
> "As stated in the above some of these actions might prove partially successful but in a much lesser amount than claimed. Still we hold that were all of these probable recoveries added together they are more than met by the consideration set forth in the agreement."

Petitioners' efforts to minimize the value of the consideration verge on the ridiculous. They baldly assert that "it is a sharply disputed question, whether the guaranty really constituted any consideration at all * * *" (Pet. p. 8) notwithstanding the findings of both lower courts based on substantial and undisputed evidence that the guaranties were of tremendous value (R. 1-247-256, 9-4767-9) estimated at millions of dollars. Except for the cash in excess of $1,300,000, petitioners object to the consideration as being "largely intangible" as though that made it relatively worthless. However, the District Judge

and the Court of Appeals concluded otherwise. As the latter observed, the giving of the guaranties "• • • meant the difference between continued existence and a liquidation that would have been a complete loss to the stockholders" (R. 9-4769). That such consideration is difficult of evaluation or "largely intangible" makes it not one whit less valuable. Petitioners are finally reduced to the absurdity of complaining that subsequent events show that the Corporation has lost money (Pet. p. 5) and suggest that perhaps it would have been better to liquidate. Such an argument by hindsight has no standing as the Court of Appeals observed (R. 9-4757, 4769-70).

A study of the record in this case and the exhaustive opinion of the District Judge makes it clear that in no other case has a District Court more painstakingly and carefully discharged his duties under Rule 23(c).

The Court of Appeals affirmed upon grounds which properly recognized its functions as an appellate tribunal. It recognized that the District Judge, in passing upon the fairness of the settlement, fully and fairly explored every angle of the controversy and made findings based upon evidence which the District Judge in the exercise of his judicial discretion had an opportunity to evaluate.

The whole approach of the petitioners is to ignore the findings of fact of the District Court found by the Court of Appeals to be supported by substantial evidence, but those findings are conclusive and leave nothing for this Court to review.

Argument.

I.

The Petition is founded on a false assumption.

Each of the five questions stated by petitioners (Pet. pp. 10-11) and each of four reasons assigned (Pet. pp. 11-23) is based upon a premise which has no foundation or justification either in the decision of the Court of Appeals or in the judgment of the District Court which the Court of Appeals affirmed.

Petitioners falsely assume that the settlement agreement which was approved was fraudulently negotiated and that the Court of Appeals disregarded this fact in affirming the judgment below. This assumption ignores the express finding of the District Judge that there was no *"collusion, fraud, concealment or unfair dealing in arriving at the compromise and that there was 'arms-length bargaining'"* (R. 1-242), which finding, rather than being disregarded, was expressly affirmed by the Court of Appeals as based *"upon the consideration of substantial evidence and in the exercise of sound judicial discretion"* (R. 9-4758).

Substantially all record references to factual statements in the petition and the appendix thereto are not to the transcript of testimony or the findings of the Courts below but to Judge Allen's dissenting opinion, wherein she placed upon certain portions of the record her own interpretations and inferences with which the majority opinion and the District Judge who viewed the witnesses disagreed in essential respects.

It is thus apparent that petitioners would have this Court accept as facts the opinion of the dissenting Judge,

as against the findings of the Trial Court, with its opportunity of seeing the witnesses and evaluating the evidence firsthand, which were affirmed by the Court of Appeals, after reviewing the entire record, as based on substantial evidence. In short, petitioners attempt to substitute the interpretation and inferences of the dissenting judge for the actual and undisturbed findings of the District Court. The petition is no less than an invitation to this Court to try *de novo* issues of fact, even though the findings of the District Court are not here put in issue by the questions presented, and hence are not submitted as the subject of review by this Court.

Such an approach disregards the plain mandate of Rule 52(a) of the Federal Rules of Civil Procedure and is at variance with what the Court of Appeals correctly conceived the scope of the review to be when it said that under familiar rules, "* * * we are not permitted to set aside his findings unless they are clearly wrong" (R. 9-4757, 70).

Petitioners' approach conflicts with settled principle relating to review established by this Court. This Court has always recognized that appellate courts must, as the Court did here, make allowances for the advantages possessed by the trial court in appraising the significance of testimony and reverse only "clearly erroneous" findings. *Besser Mfg. Co.* v. *United States,* 343 U. S. 444, 448 (1952); *United States* v. *Oregon State Medical Soc.,* 343 U. S. 326 (1952); *Timken Roller Bearing Co.* v. *United States,* 341 U. S. 593, 596 (1951); *United States* v. *Real Estate Boards,* 339 U. S. 485 (1950); *United States* v. *Yellow Cab Co.,* 338 U. S. 338 (1949). As it has said in the past, this Court "* * * cannot undertake to review concurrent findings of fact by two courts below in the absence of a very obvious and exceptional showing of error." *Graver Tank & Mfg. Co.* v. *Linde Co.,* 336 U. S. 271, 275 (1949). No obvious and

exceptional showing of error has been or can be made on this record.

The Court of Appeals properly refused to draw from the testimony inferences contrary to those found by the District Court, as the petitioners urged it to do and now urge this Court to do. *Walling* v. *General Industries Co.*, 330 U. S. 545, 550 (1947). As this Court said in *Timken Roller Bearing Co.* v. *United States, supra,* 596, 597:

> "For the most part, this shotgun approach is actually only a dispute as to the proper inferences to be drawn from the evidence in the record; in effect, it is an invitation for us to try the case *de novo*. This Court must decline such an invitation. * * * In the present case, the trial judge, after a patient hearing carefully analyzed the evidence in an opinion prepared with obvious care. Appellant's lengthy brief has failed to establish that there was error in making any crucial, or even important, ultimate or subsidiary finding. Since we cannot say the findings are 'clearly erroneous,' we accept them. Fed. Rules of Civ. Proc. 52(a)."

Petitioners' charges of fraud, collusion and concealment were peculiarly matters for proof by oral testimony. In this connection, the attorneys who negotiated the compromise and who are here charged with fraud, concealment and unfair dealing, took the stand and testified fully. The District Court had ample opportunity to hear and view these witnesses and judge of their credibility. That Court found that there was no "collusion, fraud, concealment or unfair dealing in arriving at the compromise" (R. 1-242). The Court of Appeals affirmed. It was correct in so doing. Such a finding, based on oral testimony, is unassailable. This principle was recently considered and again approved by this Court in *United States* v. *Oregon State Medical*

Soc., supra, 339, where it quoted with approval the following statement:

> "Face to face with living witnesses the original trier of the facts holds a position of advantage from which appellate judges are excluded. In doubtful cases the exercise of his power of observation often proves the most accurate method of ascertaining the truth. * * * How can we say the judge is wrong? We never saw the witnesses. * * * To the sophistication and sagacity of the trial judge, the law confides the duty of appraisal."

Since the petitioners' basic assumption of facts is false and contrary to the findings of both Courts below, the questions predicated thereon are actually non-existent and not before this Court. Hence the petition fails.

II.

Petitioners' alleged reasons are likewise based on the same false assumption and are otherwise without merit.

The reasons assigned by petitioners for granting the writ (Pet., pp. 11-23) are predicated upon the same wholly false and non-existent basic premise that there was fraud in the making of the proposed settlement agreement. The falsity of the premise results in the collapse of petitioners' entire presentation. The alleged reasons are also without merit.

Petitioners first assert that the decisions of the Courts below announce as "a novel and unfortunate doctrine in a field of great importance" (Pet., p. 12), a rule of law under which a court may approve a settlement regardless of the presence of fraud in the making. On the contrary, the District Court expressly recognized that an issue which it

"must necessarily settle" before proceeding to the consideration of the stockholders' claims and the adequacy of the consideration, was the propriety of the settlement negotiations. The Court said:

> "Another issue which we must necessarily settle before proceeding is objecting stockholders' contention that the proposed settlement agreement should not be approved because, first, it is not the valid act of Kaiser-Frazer or anybody competent to act for Kaiser-Frazer; second, it was not arrived at by arms'-length bargaining in good faith; third, failure to include attorneys for objecting stockholders; and, fourth, there was collusion" (R. 1-236).

In this connection, the same cases[3] as are here relied upon by petitioners were cited to the District Court in support of the position that freedom from fraud in negotiations is a condition prerequisite to any compromise of a derivative action. The District Court adopted the law of these cases and said:

> "* * * These cases are in point and are authority for the legal conclusion that if there's fraud, collusion or unfair dealings on the part of the directors of the corporation in arriving at the settlement the court will set it aside. *We have no quarrel with those decisions.*
>
> "But here we do not find any collusion, fraud, concealment or unfair dealing in arriving at the compromise and we hold there was 'arms-length bargaining.'" (R. 1-242) (Emphasis supplied.)

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[3] *Goodwin* v. *Castleton*, 19 Wash. 2d 748, 144 Pac. 2d 725; *Karasik* v. *Pacific Eastern Corporation*, 21 Del. Chan. 81, 180 Atl. 604; *Perrine* v. *Pennroad Corporation*, 47 Atl. 2d 479 (Del.) cert. den. 329 U. S. 808; *Feldman* v. *Pennroad Corp.*, 155 F. 2d 773 (C. A. 3), cert. den. 329 U. S. 808. Cited to and considered by the District Court (R. 1-245-246). Cited to this Court (p. 12 of Petition).

Petitioners next contend that the Court of Appeals misconceived the function of the District Court in passing upon a proposed settlement. To the contrary, the Court of Appeals correctly recognized the role of the District Judge under Rule 23(c). This was a "proposed settlement" bargained for with the knowledge that it must have judicial sanction after notice to all parties in interest and expressly conditioned upon that sanction. Thus, the power resided in the Court, not the stockholder-plaintiffs, to compromise the rights of the Corporation. So when petitioners complain that, under the reasoning of the Court below, the District Judge becomes the sole representative of the Corporation whose decision is final (Pet. p. 13), they simply take issue with settled principles established by the very cases they rely on. Thus, in *Denicke* v. *Anglo California Natl. Bank,* 141 F. (2d) 285 (C. A. 9, 1944), cert. den. 323 U. S. 739, the Court said (288):

> "His position (the stockholder-plaintiff) in the litigation is assimilated to that of a guardian *ad litem with power in the court, not in the stockholder, to compromise the rights of the real party in interest, which is the corporation itself.*" (Emphasis supplied.)

The existence of an agreement of settlement is not even a condition precedent to the Court's consideration of a proposed settlement. *Winkelman* v. *General Motors Corporation,* 48 F. Supp. 490 (S. D. N. Y. 1942).

As the Court of Appeals said, "The settlement agreement did not, and could not, become effective without the approval of the Court under the mandate of Rule 23(c)" (R. 9-4758):

Petitioners next argue that the decision below vests the District Court with "non-judicial power" (Pet., pp. 17-19).

The purpose of Rule 23(c) was to require judicial approval after notice and hearing to the end that litigants in a derivative action might not dispose of the action to the detriment of the Corporation and its stockholders. Hence, the power to compromise vests finally in the Court, not in the litigants. *Denicke* v. *Anglo California Natl. Bank, supra; Goodwin* v. *Castleton, supra,* 764; *Whitten* v. *Dabney,* 171 Calif. 621, 630. It may not be compromised simply because all parties before the Court agree that it is best to do so. *Cohen* v. *Young,* 127 F. (2d) 721 (C. A. 6, 1942) cert. den. 321 U. S. 778. The District Court is the protector of the interests of the Corporation and its absent stockholders and he, and he alone, must by judicial investigation and examination be convinced that the compromise is in their best interests and should be approved.[4] He is, in that sense, as the Court of Appeals correctly described him to be, "a third party to the compromise,"—a disinterested party concerned solely with the best interests of the Corporation and its stockholders.

In assessing what is for the best interests of the Corporation and its stockholders the District Judge necessarily exercises broad judicial discretion. Such is the settled law with respect to Rule 23(c). *Cohen* v. *Young, supra; Berger* v. *Dyson,* 111 F. Supp. 533 (D. C. R. I. 1953). It is the general law in the approval of compromises of litigation. *Ladd* v. *Brickley,* 158 F. (2d) 212 (C. A. 1, 1946), cert. den. 330 U. S. 819; *Pullman Couch* v. *Eshelman,* 1 F. (2d) 885

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[4] This is apparent from McLaughlin's article, "Capacity of Plaintiff-Stockholder To Terminate a Stockholder's Suit" (46 Yale Law Journal 421, 1936) the only authority referred to by the Supreme Court's Advisory Committee on Rules which drafted Rule 23. There the author said that if "*the court has doubts as to the open mindedness of the directors,* it may disregard entirely the assent of the corporation, *and, after examining all the circumstances, reach an independent decision on the fairness of the settlement.*" (Emphasis supplied.)

(C. A. 4, 1924), cert. den. 266 U. S. 631. In the exercise of that discretion the Trial Judge is necessarily concerned with the weighing of many imponderables, such as the effect of litigation and consequent publicity on the Corporation's credit, *Denicke* v. *Anglo California Natl. Bank, supra;* diversion of officers' time by protracted litigation, *Berger* v. *Dyson, supra;* ultimate collectibility of the judgment, *Cohen* v. *Young, supra;* effect of the litigation on the rights and property of the stockholders, *Goodwin* v. *Castleton, supra,* 733. He weighs the probabilities of recovery but is not committed to a determination of the merits of the controversy. *Berger* v. *Dyson, supra.*

As stated in *Koster* v. *Lumbermens Mutual Co.,* 330 U. S. 518, 525-6 (1947), in construing Rule 23(c):

> "Thus, such a litigation [hearing on the settlement of a stockholders' suit] brings to the Court more than an ordinary task of adjudication; it brings a task of administration; * * *."

The task thus undertaken has been described as calling for the exercise of "business judgment." *In Re Ortiz' Estate,* 26 Del. Ch. 240, 27 A. (2d) 368, 374 (1942). It is nonetheless a judicial discretion based on findings of fact and conclusions of law which in this instance were meticulously and fully set forth and afforded a ready basis for review to determine whether that discretion was abused. The process in nowise partakes of the delegation of legislative or administrative power as in the *Keller, Radio Commission* and *Porter* cases cited (Pet., p. 19). It is a judicial process in a traditionally judicial field, the disposition of litigation pending before the Court.

Petitioners next argue (Pet., pp. 19-20) that the decision below conflicts with *Erie Railroad* v. *Tompkins.* Their argument proceeds on two false assumptions. The first is

common to all the reasons given by petitioners, *i. e.*, that there was fraud and collusion in the negotiations. As has been demonstrated above, this assumption has no basis in fact, the finding below being to the contrary. Petitioners' point has no merit without this assumption. The District Judge actually applied the doctrine of the *Erie* case (R. 1-241-247). The second false assumption is that the defendants to the derivative suit *obtained* releases, the validity of which should be determined according to state law. May we emphasize again that what was offered the District Court was a *proposed* compromise which included a *proposed* release. As both courts below correctly pointed out, we are not here confronted with an *executed* transaction (R. 1-241, 9-4757-8). The agreement was expressly conditioned upon judicial approval and could have no effect without that approval (R. 1-161).

Petitioners concede (Pet., pp. 20-23) that the District Judge was vested with discretion but in their fourth reason contend that the District Judge abused that discretion. It necessarily follows that they had to show a clear abuse of that discretion to prevail in the Court of Appeals. The points made by them as showing an abuse of discretion demonstrate clearly why this petition should be denied, for each involves at best a conflict in evidence as to which the District Judge found against them and was affirmed by the Court of Appeals.

Thus the petitioners talk of "adjudicated breaches of fiduciary duty by corporate directors and managers" (Pet. p. 20). There was, of course, no adjudication as there was no trial on the merits, but in any event the finding was to the contrary, the District Court saying, "We have come to the conclusion and hold that in none of the transactions has there been any fraud, collusion or attempt to benefit * * * at the expense of Kaiser-Frazer" (R. 1-256). These

findings were affirmed on appeal as being based on substantial evidence.

Petitioners state that there was "adjudicated probability of large recoveries for such breaches and strong indications * * *" that there may be recovery on the Permanente claim (Pet. pp. 20-21). The Permanente claim was unequivocally ruled out by both courts on the basis of findings of facts having substantial support in the record (R. 9-4762; 1-289). The District Judge in the settlement proceedings assessed the possibilities of recovery as to each alleged cause of action. The "large recoveries" envisaged have no basis other than in petitioners' claims. The District Judge thought there might be a recovery of a comparatively small amount (R. 1-247). The Court of Appeals thought there might be some additional recovery on the stabilization claim, but in an amount so uncertain as to have no substantial effect on the fairness of the compromise (R. 9-4767).

Petitioners claim that acceptance of a "consideration for such settlement for the most part intangible and not susceptible of dollar evaluation" constitutes abuse (Pet., p. 21). The fact is that a valuation of many millions was placed upon the guaranties by undisputed evidence. Both courts concluded, with substantial evidence to support the finding, that the guaranty spelled the difference between continued existence and a liquidation that would have been a complete loss to the stockholders. There was no abuse of discretion in that finding (R. 9-4769).

Conclusion.

The decision of the lower courts does not present any novel or important question of legal principle warranting review by this Court. It involves only application of settled

principle to the facts of the case. The finding and conclusion that the settlement was in the best interests of the corporation and its stockholders was within the sound judicial discretion of the District Judge and the Court of Appeals was correct in finding no abuse of that discretion. Petitioners' contentions would require a review of the findings of fact and a trial *de novo* of the issues involved contrary to the decisions of this Court and Rule 52(a) of the Federal Rules of Civil Procedure. The decision below does not conflict with any decisions of this Court or of any other Court of Appeals. No substantial question of construction of any Federal law is involved. Accordingly, no ground for review by this Court exists.

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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AUG 1 1953
HAROLD B. WILLEY, Clerk

IN THE

Supreme Court of the United States.

OCTOBER TERM, 1952.

No. 133.

JAMES F. MASTERSON, MICHAEL STELLA, EVA LEFKER and OTIS & COMPANY,

Petitioners,

v.

JEROME R. PERGAMENT and GEORGE J. LONDON, *et al.*, JOSEPH W. FRAZER and HENRY J. KAISER, *et al.*,

Respondents.

REPLY BRIEF ON BEHALF OF PETITIONERS.

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REPLY BRIEF ON BEHALF OF PETITIONERS.

Respondents take two positions:

(1) They do not deny that if the Court of Appeals held on the question of fraud in the making of the settlement as petitioners say, the holding should be reviewed by this Court, and they even imply that there would have to be a reversal (Kaiser, pp. 6, 12-13; Pergament, pp. 6-7*). Respondents simply deny that the Court of Appeals so held. They argue that all the majority did was to affirm an alleged finding by the District Judge that the fraud was not committed.

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* Unless otherwise indicated "fraud" is herein used in the sense of unfairness and other constructive fraud, which is the type of fraud which Judge Allen found to exist (9-4745). The brief of Joseph W. Frazer, Henry J. Kaiser, *et al.* is cited as "Kaiser"; the brief of Pergament and London is cited as "Pergament".

(2) At the same time, however, the Kaiser brief recognizes that the Court of Appeals *did* make the holding which petitioners are seeking to get reviewed, and the brief argues in support of such holding. At page 14 it is stated that "the Court of Appeals correctly recognized the role of the District Judge under Rule 23 (c)" and that "the power resided in the court, not the stockholder plaintiffs, to compromise the rights of the corporation"; hence there is nothing wrong in the fact "that under the reasoning of the court below, the District Judge becomes the sole representative of the corporation whose decision is final."

Respondents base their first position solely on quotation, out of context, of one sentence from the majority opinion of the Court of Appeals, and seek to buttress it by inaccurate statement of the holding of the District Court, and by incomplete quotations from its opinion. The second position, not advanced as an alternative, obviously cancels out the first, and leaves for decision the question whether this Court should review the holding below or let it stand as precedent.

POINT I.

The majority below held that, under Rule 23(c) F. R. C. P., fraud in the making of the settlement is no bar to its approval.

The Opinion of the Court of Appeals:

As shown by the majority opinion, Judge Allen's opinion was originally prepared for the Court—whether the unanimous Court or a majority is not stated (R. 9-4756). The result, contrary to the usual

procedure, was that where there was unanimity the majority established it by agreeing with, or not differing from, what is now the dissent, and where there was difference the majority stated it in terms of departure from the dissent.

This is important, because on the point now of interest—fraud in the *factum* of the settlement—*the only facts set out in either opinion are those recited by Judge Allen, and the majority did not disagree with them or with her legal conclusion that they constituted fraud.* Judge Allen also pointed out that these facts were, respectively, "admitted" (R. 9-4740), "admittedly" so (9-4741, 4742), "undisputed" (9-4742), and "conceded" (9-4743); and the majority did not differ as to this either. The majority position was that the facts stated and the conclusions drawn by Judge Allen on the question of fraud could be accepted as correct but were immaterial.

This appears practically at the outset of the majority opinion by necessary implication, and a little later by direct statement.

At the outset, after stating certain general points of agreement with Judge Allen, the majority said (R. 9-4756):

> "It has always been our view however that the principle governing responsibility for inequitable or illegal conduct is not to be applied in a vacuum but that those who complain of it must show *that they were injured thereby* (citing cases). This leads us to the view that the *crucial question* in this derivative suit is whether the settlement arrived at between representatives of the stockholders and the corporate and individual defend-

ants was, at the time and under the circumstances in which it was arrived at and considered by the district court, *for the best interests* of the Kaiser-Frazer Company. The district judge after thirteen weeks of trial and meticulous consideration of the evidence *so held* and, under familiar rules, we are not permitted to set aside his findings unless they are clearly wrong." (Emphasis supplied above and hereafter unless stated to the contrary.)

Judge Allen, in her opinion from which the majority was expressing dissent, had set out in great detail the fraud in the bargaining, and the majority did not disagree. It is everywhere conceded that, Rule 23(c) aside, fraud in the bargaining is fatal even without proof of injury; and of course the majority knew that the petitioners were contending that the result was the same under Rule 23(c), and that Judge Allen agreed with them. Hence, the requirement that petitioners must show injury if they are to complain, plus the insistence, notwithstanding the undisputed facts as to fraud, that the "crucial question" was nevertheless whether the settlement was "for the best interests" of Kaiser-Frazer, makes it plain at the outset that the majority thought that fraud in the bargaining was immaterial when the bargain had to be approved by the District Court under Rule 23(c).

This is confirmed by the majority's direct statement of immateriality. After discussion not here pertinent, appears the following paragraph, in which respondents ignore everything except the last sentence (R. 9-4658):

"We are not to be led into a discussion of the many contentions urged upon the court to the

> effect that the negotiators of the settlement on behalf of the corporation were not fully informed; that material information was concealed from them; that the lawyers participating occupied a dual role; or that there was no arm's length bargaining. The settlement agreement did not, and could not, become effective without the approval of the court under the mandate of Rule 23 (c). The District Judge was, therefore, a third party to the compromise. There is no contention, and there could be none, that in approving the compromise important information was concealed from him or that his participation in the settlement was subject to any infirmity. Every possible aspect of opposition was fully by him explored. In any event, he ruled against the objectors upon these matters upon the consideration of substantial evidence and in the exercise of a sound judicial discretion."

Respondents would have it that in the words "these matters" the majority were referring to petitioners' charges of fraud in the negotiations. This is untenable. The paragraph must be read as a whole. The first sentence dismisses the charges of fraud as requiring no discussion. The rest of the paragraph explains *why* this is so. The reason given is, that in view of the position of the District Judge under Rule 23(c), full and frank disclosure to him of the facts bearing upon the merits of the settlement cures any prior non-disclosure or suppression; and such disclosure having been made to the District Judge, so that he had all the important information and "every possible aspect of opposition was fully by him explored," there is no further ground of complaint on this score. The concluding sentence follows logi-

cally from what went before. What it says is, that the District Judge having found upon substantial evidence that the settlement was for the best interests of the corporation, he ruled in the exercise of a sound judicial discretion that it should be approved.

On the respondents' interpretation, the last sentence not only has nothing to do with what precedes it in the same paragraph, but actually negates everything that precedes it. On this interpretation, we have the majority first saying emphatically that they will *not* be led into discussion of the fraud issue, then explaining fully *why* not, but nevertheless in the end reversing themselves, and reviewing and ruling upon the very matter which they had said at the outset they would not go into. This is not interpretation, but distortion.

Furthermore, the respondents' interpretation would have the majority saying that the proof as to fraud in the negotiations had been "fully explored" by the District Judge, and that he had found on this issue "upon substantial evidence." However, the record shows conclusively, *first,* that the petitioners were repeatedly and emphatically shut off from making their proof as to fraud, on the precise ground that the District Judge considered the subject immaterial; *secondly,* that there was no substantial evidence to controvert the facts as to fraud which are set out in Judge Allen's opinion. The majority could not possibly have intended to say what the respondents would have them saying. The following brief consideration of what happened in the District Court demonstrates this.

The District Court Proceedings and Opinion:

(1) The District Judge repeatedly refused to take the petitioners' evidence as to fraud (*e.g.*, 7-3819, 3835, 3845, 3863, 3908, 3953, 3956, 3963-5), basing his refusal on the precise ground that the issue was immaterial. For example, at p. 7-3961 the court said: "All right, but it is immaterial. The question now is, 'Is this a fair settlement in view of the information that you have now?' That is all there is to it. * * *" At p. 3962, in the same context, the court said again "The question is 'Is this a fair settlement?' Not how smart the attorneys (for the settling stockholders) were, or how much they knew"; and at p. 3965: "And it is immaterial what information they had." So strictly were petitioners limited in this regard, that at one point they had to resort to an offer of proof, to which objection was once again sustained on the ground of immateriality (R. 7-3963-5). It is imputing unfairness to the District Judge—and certainly confessing reversible error—to say that he made a finding of fact on a matter as to which, on the ground of immateriality, he refused to take a large part of the proffered proof.

(2) The District Judge gave two reasons for the ruling of immateriality. The first (the alleged special powers conferred by Rule 23) requires no further discussion. The second was his refusal to recognize that the settling stockholders were fiduciaries (R. 7-3966). He would go no further than to say, in effect, that if petitioners could make a case of common-law fraud, he would listen, but such things merely as non-disclosures and suppressions were of no moment. Immediately following his ruling (R. 7-3849) that he could not entertain evidence as to

whether or not "everything was aired" in the negotiations, he said: "If you can find any phenagling,* all right, but I will rule on the questions as you ask them;" and he ruled as already indicated.

In short, it was only despite the court's expressed attitude, and only by virtue of occasional and infrequent relaxations from it, that petitioners succeeded in getting into the record the uncontradicted evidence as to fraud which is set out in Judge Allen's opinion. Accordingly, it would have been extraordinary for the District Judge to have found, as argued by the respondents, that there was no fraud in the bargaining. This would have involved not only error in ignoring the undisputed evidence that did get into the record, but also unfair treatment of petitioners in refusing to admit additional evidence of such concealment because it was immaterial and then finding against petitioners on the issue.

The District Judge did not so find. He merely refused to make findings on the issue.

On the charge of concealment the District Judge said at R. 1-240 that "the important thing is that this Court—*while not admitting there was any such concealment*—now has the facts." And at 1-242 he repeated his negative holding "But here we do not find any collusion, fraud, concealment or unfair deal-

* To "phenagle," more commonly spelled "finagle," means, among other things, "to cheat" (Webster's New International, Second Edition, 1947), of which, in turn, the first meaning in Webster's is "to deprive of something valuable by use of deceit; to practise fraud upon; to defraud; swindle; as *to cheat* a man out of his savings." This, we believe, is the common use of "finagle" and what the learned Court evidently meant was that misconduct not arising to that degree would not be, in his view, adequate grounds for attacking the bargain.

ing in arriving at the compromise." This statement is immediately followed by the affirmative holding "and we hold that there was 'arm's length' bargaining."

The refusal to find concealment parallels the Court's earlier refusal to find on the same subject, "while not admitting that there was any such concealment." The positive finding of arm's length bargaining parallels the earlier positive finding on the same subject—"and we naturally believe defendants were trying to get as favorable an agreement as they could. On the other hand, plaintiffs were trying to drive as good a bargain as they could."

Since the burden of proof on the issue of fairness in the negotiations was on respondents (*Pepper* v. *Litton,* 308 U. S. 295, 306; *Geddes* v. *Anaconda Copper Mining Company,* 254 U. S. 590, 599; *American Mutual Life Insurance Company* v. *Avon Park,* 311 U. S. 138, 145, 146), failure to find on this issue is equivalent to a finding by the District Court in favor of petitioners.

Accordingly, what happened in the District Court makes plain that respondents have misconstrued the statement in the majority opinion that the District Judge "ruled against the objectors upon *these matters* upon the consideration of *substantial evidence* and in the exercise of *a sound judicial discretion.*" The words "these matters" refer back to the immediately preceding statement, that "every aspect of opposition was fully by him explored." However, fraud in the negotiations as an aspect of opposition was *not* fully explored by the District Judge; on the contrary, he constantly belittled it as immaterial, ad-

mitted a part of the evidence only grudgingly, and excluded the rest. Additionally, "these matters" *cannot* refer to the issue of fraud, because that was not an issue which the District Judge decided against petitioners "upon the consideration of substantial evidence." Finally, a finding as to whether there was fraud or not, *could not* be the subject of an "exercise of a sound judicial discretion;" findings of fact are not matters of discretion. The construction which the respondents seek to put upon this sentence is plainly impossible.

POINT II.

This Court should review the erroneous precedent established by the ruling of the majority below that fraud in the bargaining is immaterial, even though it considers that the decision may also have rested on the alternative ground that there was no such fraud.

Respondents cannot escape the fact that the majority of the Court of Appeals held that fraud in the bargaining was immaterial. The best they can hope is to persuade this Court that the majority ruled, in addition, that there was no fraud in the bargaining. On this assumption the opinion and decision fall within the rule that "where there are two grounds, upon either of which an appellate court may rest its decision, and it adopts both, 'the ruling on neither is *obiter* but each is the judgment of the court and of equal validity with the other.' " [Citing cases.] *United States of America* v. *Title Insurance & Trust Company,* 265 U. S. 472, 486. See also, *Woods* v. *Interstate Realty Company,* 337 U. S. 535,

537.* Accordingly, the ruling as to the law, which we seek to have reviewed, now stands as precedent, and the case at bar is one for review if this Court deems the question presented to be of sufficient importance. *Hurn* v. *Oursler,* 289 U. S. 238.

In the *Hurn* case, plaintiff sued for violation of copyright and unfair competition. Both claims were based upon a single alleged wrong, defendant's appropriation of certain ideas and situations in plaintiff's play. The District Court found that there was no infringement of copyright, gave judgment on the merits for defendant on this claim, and dismissed the claim of unfair competition for want of jurisdiction, there being no diversity of citizenship. The Court of Appeals affirmed *per curiam* on the authority of cases cited. This Court granted certiorari, and said (p. 240):

> "While, as presently will appear, the claim of unfair competition is without merit and the dismissal must stand in any event, it is important that if the determination of the court was put upon the wrong ground we should so declare, that it may not be followed as a precedent."

The Court then decided that the decision below was wrong in dismissing for want of jurisdiction the claim of unfair competition, because jurisdiction of the federal claim based upon violation of copyright gave the court jurisdiction to determine common law rights based upon identical facts. Further finding that these

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* Even the fact that the case was finally disposed of upon one ground does not relegate the other to the category of dicta, so long as this other ground was presented on the record and passed upon by the court. *Florida Central R. R. Co.* v. *Schutte,* 103 U. S. 118, 143.

facts also required dismissal of the unfair competition claim, this Court affirmed upon the merits.

The briefs on the application for certiorari reveal that the respondent Brentano strenuously opposed review on the ground that the claim of unfair competition had been eliminated by the finding of no infringement, which was not sought to be reviewed (Point I). Under Point II he argued that the allowance of this appeal would permit the raising of a purely abstract question; that the only facts alleged in the complaint bearing upon the question of unfair competition had been forever eliminated by the finding of no infringement; and that it was therefore apparent that requiring the consideration by the trial court of an alleged claim of unfair competition would be a useless formality. Other respondents made similar arguments. Even after the grant of certiorari the Brentano brief continued to argue that "the purpose of a decision on appeal is to apply the rules which govern the facts of the particular case being considered, not to lay down dicta which may affect any other cases." Nevertheless, this Court (1) granted certiorari, (2) did not dismiss the writ as improvidently granted, and (3) considered and decided the point presented.

Subsequent decisions of this Court are in accord. *Armstrong Paint & Varnish Works* v. *Nu-Enamel Company*, 305 U. S. 315, 324, fn. 6; *United States* v. *United States Gypsum Co.*, 333 U. S. 364, 387.

Accordingly, even if this Court accepts respondents' argument that the decision below may be supported on factual grounds, the case still merits review be-

cause of the important and erroneous legal precedent that the Court of Appeals undeniably laid down as a basis for its decision.

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Petitioners in their Reply Brief (pp. 1, 2) take upon themselves to state Respondents' position and from our refusal to be drawn into argument of the merits of the non-existent legal question on which they seek certiorari deduce our concurrence in their views concerning the same. Such is not the fact. We neither admit that *if* there is fraud, there is a reviewable question, nor do we imply there would have to be a reversal *if* there were fraud in the negotiations. No such question is presented on this record. Petitioners'

question is purely hypothetical. The fact is that both lower courts found there was no collusion, fraud, concealment or unfair dealing in arriving at the compromise and that there was "arm's-length bargaining". In the light of that express finding, based on the oral testimony of all parties to the negotiations, it is clear that there is no question presented for review by this Court.

Petitioners' Reply Brief is based upon their false premise that the District Court held that the alleged fraud in the negotiations was immaterial and their belated and equally false assertion *(now made for the first time and clearly beyond the scope of the sole issue presented in their Petition for certiorari)* that "the District Judge repeatedly refused to take the Petitioners' evidence as to fraud" (Reply Brief, p. 7). Actually the District Judge throughout the hearings repeatedly ruled that evidence tending to show fraud, collusion, concealment or non-disclosure was admissible.[1] Despite Petitioners' threats and promises and despite the latitude given them by the District Judge, such evidence never did appear (R. 7-3853). The record references which Petitioners cite in support of their statements relate in each case to their lengthy cross-examination of the attorneys who negotiated the settlement, which occupies some 500 pages of the record (R. 3-699-1045, 7-3802-3975). A review of this testimony reveals that Petitioners were repeatedly permitted to go beyond all normal bounds and were never precluded from any examination the object of which was to determine whether there was suppression, concealment or non-disclosure of facts or any fraud, col-

[1] e. g., the District Court said (R. 7-3902-3): "• • • there is also the possibility in these suits of collusion; and if there is any (705) collusion in the settlement, the Court will not approve of any settlement. If, either directly or indirectly, they can show collusion, they have the right to, or if they can show a false reason, they have that right. • • •"

lusion or unfair dealing. The few rulings against Petitioners involved improper questions. Petitioners acknowledged that there was no evidence of "conscious wrongdoing" or "dishonesty" on the part of the negotiators (R. 7-3848-3905). Reduced to its lowest terms their sole complaint is that stockholders' attorneys at the time of negotiations did not have the composite knowledge which all attorneys and the Court developed during thirteen weeks of trial, which Petitioners say disqualified them as proper negotiators. The absurdity of this position the District Court quickly recognized.[2] Such a requirement would render settlements a practical impossibility,[3] and set up an insurmountable barrier to peaceful settlements which are universally favored by the courts. *Williams* v. *First National Bank*, 216 U. S. 582, 595. No serious claim can be made that stockholders' attorneys did not have adequate knowledge of the litigation as their presentation and testimony clearly indicates (R. 2-311-463, 7-3942-3975), a fact that was recognized by the Court (R. 7-3848).

The statements of the District Judge quoted out of context on page 7 of Petitioners' brief did not, as is made to appear, involve exclusion of any evidence bearing on fraud as Petitioners assert. Those statements were solely and correctly upon the proposition that if the court should find upon all the evidence that the settlement was for the best interests of the Corporation and its stockholders it would be absurd to refuse to approve it because the nego-

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[2] (R. 7-3954) where the Court said: "Why, gentlemen, no, no. They did not have to know all the possibilities, especially the possibilities that have developed as a result of ten or eleven weeks of a lawsuit."

[3] (R. 7-3950) where the Court said: "• • • I know this, that in a suit of this size, no one attorney could know all the possible exhibits and ramifications, and undoubtedly since this case has started, attorneys on both sides have learned a lot about the other side's position in the case."

tiators did not know some detail of the evidence which would not materially affect the result.

The District Judge recognized that fraud or collusion in the settlement was one of the issues before him and that if either were established he would not approve the settlement (R. 7-3849, 3903, 3906, 3946). After the hearings exhaustive briefs were submitted, devoted in part to Petitioners' claims of fraud and collusion. Thereafter, the District Judge found in his opinion that there was no collusion, fraud, concealment or unfair dealing and that there was "arm's-length bargaining" (R. 1-242). Further, so that there might be no possible misunderstanding, the District Court in its Order Approving the Compromise expressly stated "* * * that said agreement of settlement and compromise was arrived at fairly and in good faith * * *" (R. 1-291). It is therefore idle for the Petitioners to argue that the District Judge made no such finding, gave no consideration to the question, and held it to be immaterial.

Petitioners' construction of the Court of Appeals' opinion is erroneous. They indulge in the unwarranted assumption that Judge Allen's dissent was originally that of the majority, who later changed their minds and decided for affirmance. It appears more probable that Judge Allen was originally designated to write a unanimous opinion for affirmance and then changed her mind. In any event such speculation does nothing to further Petitioners' argument. The fact is that there was one controlling opinion and decision of the Court of Appeals—that of the majority.

The statement by Petitioners that the majority of the Court did not disagree with Judge Allen as to fraud in the negotiations is without basis in fact. The majority expressly enumerated those matters of fact and propositions

of law recited in the dissenting opinion with which they were in agreement (R. 9-4756).[4] They did not include Petitioners' allegations with respect to the adequacy of the notice and their numerous contentions relating to fraud. Everything which follows in the majority opinion is contrary to the findings of the dissenting Judge. The majority separately considered the adequacy of the notice to stockholders (R. 4757), the *alleged improprieties* in the settlement negotiations (R. 9-4758), the probabilities of recovery on the various causes of action (R. 9-4759), the adequacy of the consideration (R. 9-4767-4769), and the soundness of the judicial discretion exercised by the District Judge (R. 9-4758, 4770). The Court rejected Petitioners' contentions as did the District Court.

Petitioners under the heading "Point II", seek to broaden their petition for certiorari by urging that:

> "Accordingly, even if this Court accepts respondents' argument that the decision below may be supported on factual grounds, the case still merits review because of the important and erroneous legal precedent that the Court of Appeals undeniably laid down as a basis for its decision." (Concluding paragraph of Petitioners' Reply Brief, pages 12-13.)

The quoted language is important for its tacit admission that the decision below may be supported on factual grounds, because Petitioners' alleged basis for certiorari

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[4] "It becomes unnecessary, however, to review much of what has been said therein as to the origin of the litigation, the relationship of the parties and the circumstances not controverted in the various transactions here challenged as being violations of a fiduciary obligation of the directors of Kaiser-Frazer Corporation to its stockholders. Nor have we any quarrel with its statement of law which requires meticulous scrutiny of transactions between corporations having over-reaching boards of directors and executive officers" (R. 9-5756).

cannot be broadened by a supporting brief and, *a fortiori*, by a reply brief:

General Talking Picture Corporation v. *Western Electric Company*, 304 U. S. 175:

> "Whether included in the petition or separately presented, the supporting brief is not a part of the petition, at least for the purpose of stating the questions on which review is sought."

However, the proposition that this Court should grant certiorari merely to affirm a right result reached below for several reasons one of which is claimed to be capable of erroneous interpretation (by those interested in so doing) is so contrary to the basic concepts of appellate jurisdiction and of certiorari as to carry its own refutation regardless of how suggested.

The cases* cited and quoted from by Petitioners at pages 11 and 12 of their Reply Brief are not in point. This Court's policy concerning review by certiorari has been carefully promulgated in its Rule 38, Section 5. It is sufficient to say that such review is, as it must be, sparingly granted and is not extended as an invitation to tilt with windmills.

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* *Hurn* v. *Oursler*, 289 U. S. 238, and *Armstrong Paint & Varnish Works* v. *Nu-Enamel Company*, 305 U. S. 315, do not touch upon this Court's policy concerning granting of certiorari but are opinions on the merits and express caveats regarding the scope of the affirmance.

United States v. *United States Gypsum Co.*, 333 U. S. 364, involved a direct appeal to this Court.

We submit that the petition for writ of certiorari should be denied.

Respectfully submitted,

ROCKWELL T. GUST,
Counsel for Respondents, Joseph W. Frazer, Henry J. Kaiser, Edgar F. Kaiser, G. G. Sherwood, E. E. Trefethen, Jr., Clay P. Bedford, W. A. MacDonald, Hickman Price, Jr., and Kaiser-Frazer Corporation.

HAROLD J. GALLAGHER,
Counsel for Respondent, Kaiser-Frazer Corporation.

BUTZEL, EAMAN, LONG, GUST & KENNEDY,
WILLKIE OWEN FARR GALLAGHER & WALTON,
Of Counsel.

JUL 29 1953
HAROLD B. WILLEY, C

In the Supreme Court of the United States

OCTOBER TERM, 1953.

No. 133.

JAMES F. MASTERSON, MICHAEL STELLA, EVA LEFKER and OTIS & COMPANY,

Petitioners,

v.

JEROME R. PERGAMENT and GEORGE J. LONDON, *et al.*, JOSEPH W. FRAZER and HENRY J. KAISER, *et al.*,

Respondents.

MOTION FOR LEAVE TO FILE AMICUS CURIAE BRIEF.

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Respondents.

MOTION FOR LEAVE TO FILE AMICUS CURIAE BRIEF.

The Kaiser-Frazer Stockholders Protective Committee respectfully applies to this Court for leave to file a brief as an *amicus curiae* in the above entitled action, and submits that it satisfies the requirements respecting eligibility of such leave provided in amended paragraph 9 of Rule 27 of this Court's Rules, on the following grounds:

1. QUESTION PRESENTED.

The above entitled action arises out of a petition filed by respondents Pergament and London in the Federal District Court for the Eastern District of Michigan, Southern Division, seeking approval of a compromise settlement, pursuant to Rule 23(c) of the Federal Rules of Civil Procedure, which they had reached in a stockholder's derivative action filed on behalf of Kaiser-Frazer Corporation against respondents Kaiser, Frazer *et al.*

The settlement involved the release of various causes of action against these same defendants which were the subject of various derivative actions in other jurisdictions wherein Petitioners Masterson, Stella, Lefker and Otis and Company were the plaintiffs. The petitioners objected to the compromise but it was approved by Judge Picard in the District Court and this approval was upheld by the majority of the Court of Appeals for the Sixth Circuit on the grounds that consideration given in the settlement was adequate even though it was fraudulently conceived.

Petitioners have filed a Petition for Writ of Certiorari with this Court raising the issue of whether or not a settlement, fraudulent in its conception, can be approved by the District Courts under any circumstances. Movant is seeking permission to file a brief in support of this Petition.

2. INTEREST OF THE KAISER-FRAZER STOCKHOLDERS PROTECTIVE COMMITTEE.

The Kaiser-Frazer Stockholders Protective Committee was organized in 1948 and has as its purpose to foster and protect the interests of the thousands of small shareholders in Kaiser-Frazer Corporation. The Committee has been active at all shareholders meetings of the corporation, it has sponsored resolutions, it has sought information from management regarding various matters and it has advised and counseled shareholders throughout the country.

The membership of the Committee consists of shareholders holding up to 10,000 shares of stock in the corporation. Furthermore the committee has, when the occasion arose, been the authorized representative of shareholders holding over 700,000 shares of stock in the corporation, which is a substantial portion of the independent shareholders of Kaiser-Frazer.

The compromise settlement involved in this proceeding was naturally a matter of considerable concern to a group organized as the Kaiser-Frazer Stockholders Protective Committee to preserve the interests of minority shareholders. The Committee studied the compromise carefully and came to the conclusion that the considerations which it contained were wholly inadequate to compensate for the corporate rights being surrendered. Thereafter the Committee closely followed the proceedings in the District Court but it did not actively participate since the interests of the corporation and its shareholders were seemingly being fully protected by the objecting shareholders, who are the petitioners in the above entitled proceedings.

The committee did not seek to intervene in the District Court because it did not know that the settlement had been fraudulently obtained and quite reasonably assumed good faith in the consummation of the settlement. Certainly nothing in the notice to the shareholders regarding the settlement indicated that it had been secured by fraud. Indeed, would not such notice have been most remarkable had it stated in effect (which it did not): "This settlement was obtained by fraud but the Court thinks it is all right anyway"? Suffice it to say if the fact that this settlement was obtained by fraud had been known to this committee we would have intervened and undertaken to safeguard the shareholders' interest.

When this case reached the Circuit Court the Committee felt that for two reasons, it should intervene. First because Judge Picard had admittedly based his decision in part on the fact that no other group of shareholders had come forth to protest the compromise, and second because the Committee felt that certain points of interest

to the Kaiser-Frazer shareholders as a whole had not been fully developed by the appellants. The Committee moved for and was granted permission to file a brief in the Circuit Court regarding this matter.

The same considerations which compelled the Committee to file a brief in the Circuit Court motivate the instant request for permission to file a brief *amicus curiae*. These considerations are of even greater concern to the Committee and the shareholders it represents at this time than they have been previously because recent developments have made it clear that, unless some substantial recovery can be made against the officers and directors of Kaiser-Frazer Corporation, the shareholders of the corporation have no chance of ever getting even a token return on their investment.

3. REASONS FOR SUBMISSION OF BRIEF.

Movant's counsel has read the opinion and the brief of petitioners with great care and movant believes that there are questions of law of relevance to the issues herein which are not fully covered in petitioners' brief.

In particular, movant would like to present a broader and more comprehensive discussion of Rule 23 (c) of the Federal Rules of Civil Procedure, its purpose, scope and applicability to the facts of the instant case, including the effect of the fraud by which settlement was obtained. Movant would also like to expand the discussion, concerning the so-called Permanente cause of action and to raise the question whether a matter of such magnitude and of so clearly a controversial nature should not as a matter of law be ordered tried on its merits rather than compromised by one shareholder on behalf of 30,000 share-

holders. Finally, movant would like to present to this Court the proposition that the consideration involved in this compromise was so wholly inadequate that it called for disapproval of the compromise as a matter of law.

It has not been feasible to present the instant motion at an earlier date due to the necessity of first determining the scope of petitioners' arguments.

It is respectfully requested on the above grounds that this application for leave to file a brief amicus curiae be granted.

Respectfully submitted,

KAISER-FRAZER STOCKHOLDERS PROTECTIVE COMMITTEE.

CHARLES W. STEADMAN,
1656 Union Commerce Bldg.,
Cleveland 14, Ohio,
Attorney for Movant.

FILE
SEP 10
HAROLD B. WILL

In the Supreme Court of the United States

OCTOBER TERM, 1953.

No. 133.

JAMES F. MASTERSON, MICHAEL STELLA, EVA LEFKER and OTIS & COMPANY,

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v.

JEROME R. PERGAMENT and GEORGE J. LONDON, *et al.*, JOSEPH W. FRAZER and HENRY J. KAISER, *et al.*,

Respondents.

STATEMENT IN SUPPORT OF MOTION TO FILE AMICUS CURIAE BRIEF.

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THE GATES LEGAL PUBLISHING CO., CLEVELAND, OHIO—MAIN 1-8547

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JEROME R. PERGAMENT and GEORGE J. LONDON, *et al.*, JOSEPH W. FRAZER and HENRY J. KAISER, *et al.*,

Respondents.

STATEMENT IN SUPPORT OF MOTION TO FILE AMICUS CURIAE BRIEF.

Now comes the Movant, Kaiser-Frazer Stockholders Protective Committee, and states that the objection to its motion f r leave to file a brief amicus curiae is not well taken and that the alleged grounds for objection emphasize the need for such a brief.

Objectors Pergament and London actually held only eight (8) shares of stock of Kaiser-Frazer Corporation when the causes of action, which they are presuming to settle, arose. Despite this they question the right of the Movant, speaking for many hundred times that number of shares, to bring the facts before this Court. The objectors in effect admit that there was fraud involved in this settlement and yet they would deny the right of the committee to focus the attention of this Court directly on this fraud in a manner which Movant submits is not sufficiently accomplished by the briefs heretofore filed.

The members of the committee were notified of this lawsuit and the proposed settlement as were all the other shareholders but this notice did not contain the slightest inkling that there was fraud or collusion in the settlement. As the committee said in its Motion: "Indeed, would not such notice have been most remarkable had it stated in effect (which it did not): *'This settlement was obtained by fraud but the Court thinks it is all right anyway'*?" Had the notice told the whole story, Movant and undoubtedly many other shareholders would have raised their voices against the compromise.

Objectors should not thus be allowed to minimize the fraudulent aspects of their settlement or to continue the impression that the shareholders of Kaiser-Frazer condone this fraud.

Respectfully submitted,

KAISER-FRAZER STOCKHOLDERS PROTECTIVE COMMITTEE.

Counsel for Movant:

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1656 Union Commerce Bldg.,
Cleveland 14, Ohio.

AUG 20 19
HAROLD B. WILLEY

IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1952.

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JAMES F. MASTERSON, MICHAEL STELLA, EVA LEFKER and OTIS & COMPANY,

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Respondents.

OBJECTION TO MOTION FOR LEAVE TO FILE AMICUS CURIAE BRIEF.

THEODORE R. REIK,
Chicago, Ill.

SAMUEL I. CHESS,
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BERNARD T. HECHT,
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Detroit, Mich.

Attorneys for Respondents, Jerome R. Pergament and George J. London.

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IN THE

Supreme Court of the United States

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JAMES F. MASTERSON, MICHAEL STELLA, EVA LEFKER and OTIS & COMPANY,

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VS

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Respondents.

OBJECTION TO MOTION FOR LEAVE TO FILE AMICUS CURIAE BRIEF.

Now come Jerome R. Pergament and George J. London, respondents in the above entitled proceeding, by their attorneys, and object to the motion of "Kaiser-Frazer Stockholders Protective Committee" for leave to file brief as *amicus curiae,* and for grounds of objection, state:

The provisions of paragraph 9 of Rule 27 of the Rules of this Court were not complied with in the making of said motion, in that,

(1) The consent of the parties was not sought and was not granted or refused.

(2) The movant does not state who constitute the so-called "Kaiser-Frazer Stockholders Protective Committee", when or how it was appointed, what are its powers, or any other fact identifying the personnel of said Committee.

(3) Facts or questions of law that have not been, or reasons for believing that they will not be, presented by the parties, are not set forth, the whole motion being but a broad generalization as to what the "Committee" would like to argue if granted permission.

(4) The statement (Motion, p. 3) that the Committee did not seek to intervene in the District Court because it did not know that it was contended the settlement had been fraudulently obtained and that the Committee assumed good faith in the consummation of the settlement, is inconsistent and insincere in that, if the movant "closely followed the proceedings" as it says, (Motion, p. 3), it was definitely advised that, from the beginning, it had been contended by objectors to the compromise that the settlement negotiations were vulnerable to attack on the ground of fraud (R. 1-217, 219-220; R. 1-228-32; R. 2-308 *et seq.*). After full hearing, the District Court found against these contentions (R. 1-242) and in its final order approving the compromise specifically held "that said agreement of settlement and compromise was arrived at fairly and in good faith," (R. 1-291). The movant had every opportunity to participate in the hearing before the District Court and in the appeal, but did not ap-

pear or make its existence known until after the oral argument in the Court of Appeals.

(5) In the brief filed by the movant after oral argument in the Court of Appeals, the movant conceded that "the possibility that these negotiations entailed actual or constructive fraud *is fully discussed elsewhere in the briefs* and we do not consider it here", thus admitting that the question of the validity of the negotiations was handled by competent counsel in the Court of Appeals, who are the same counsel representing petitioners here. *Northern Securities Company* v. *United States,* 191 US 555.

For the foregoing reasons it is respectfully prayed that the Motion to file *Amicus Curiae* Brief be denied.

THEODORE E. REIN,
SAMUEL L. CHESS,
BERNARD T. HECHT,
KENNETH FISCHER,
Attorneys for respondents Jerome R. Pergament and George J. London.